Supreme Court, U.S.
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In The

Supreme Court of the United States

October Term, 1994

SOWASHEE VENTURE,

Petitioner,

v.

EB, INC., *et al.*,

Respondent.

On Petition For Writ Of Certiorari
To The United States Court Of Appeals
For The Fifth Circuit

PETITION FOR WRIT OF CERTIORARI

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QUESTION PRESENTED

Generally, section 365 of the Bankruptcy Code allows a bankruptcy trustee either to assume and perform executory contracts or unexpired leases of the debtor or to reject them if they are economically burdensome to the bankruptcy estate. Specifically, under section 365(d)(4) the trustee can assume or reject an unexpired lease of commercial real property within a 60-day period. If the trustee does not act, the lease is automatically rejected, and the trustee is statutorily compelled to immediately surrender the property to the landlord. The question presented is:

Whether a deemed rejection of a lease of nonresidential real property under section 365(d)(4) of the Bankruptcy Code, coupled with that section's requirement to immediately surrender the leased premises, means that the lease is terminated by operation of federal law or merely breached with the rights of the parties to be determined in state court.

PARTIES TO THE PROCEEDING

Sowashee Venture (Petitioner in this Court)

Eastover Bank for Savings (now EB, Inc.)[1]

Austin Development Company

J.C. Bell, Trustee in Bankruptcy for Austin Development Company

R & S Theaters, Inc.

United Artists Theater Circuit, Inc.

[1] While the case was pending before the Fifth Circuit, Eastover Bank for Savings changed its name to EB, Inc.

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PETITION FOR WRIT OF CERTIORARI

Sowashee Venture, a Mississippi general partnership, respectfully petitions for a writ of certiorari to review the Judgment of the United States Court of Appeals for the Fifth Circuit. The court of appeals erroneously construed the explicit language of the Bankruptcy Code in a manner inconsistent with decisions of other courts. Forsaking the plain language of the statute, the court ignored a clear line laid down by Congress and adopted an interpretation of the statute requiring that certain rights of parties to federal bankruptcy proceedings be adjudicated in the state courts.

OPINIONS BELOW

The opinion of the court of appeals (App. A, 1a - 14a) is reported as *In the Matter of Austin Development Co.*, 19 F.3d 1077 (5th Cir. 1994). The opinions and orders of the district court (App. C and D, 17a - 46a) and the bankruptcy court (App. E and F, 47a - 70a) are not reported.

JURISDICTION

The Judgment of the court of appeals (App. B, 15a - 16a) was entered on May 3, 1994. The jurisdiction of this Court is invoked under 28 U.S.C. § 1254(1).

STATUTORY PROVISION INVOLVED

The principal statute involved is section 365(d)(4) of the Bankruptcy Code, 11 U.S.C. § 365(d)(4), which reads as follows:

> "(4) Notwithstanding paragraphs (1) and (2), in a case under any chapter of this title, if the trustee does not assume or reject an unexpired lease of nonresidential real property under which the debtor is the lessee within 60 days after the date of the order for relief, or within such additional time as the court, for cause, within such 60-day period, fixes, then such lease is deemed rejected, and the trustee shall immediately surrender such nonresidential real property to the lessor."

STATEMENT OF THE CASE

This case began in the United States Bankruptcy Court for the Southern District of Mississippi with the filing of a voluntary petition for reorganization under Chapter 11 of the Bankruptcy Code. 11 U.S.C. §§ 101 *et seq.* The judgment of the bankruptcy court was appealed to the district court pursuant to 28 U.S.C. § 158(a). See also Fed. R. Bankr. P. 8001(a). The district court affirmed. On appeal, under 28 U.S.C. § 158(d), the Fifth Circuit reversed and remanded.

A. *Background*

The facts in this case are not in dispute and were largely the subject of a Stipulation (App. G, 71a - 80a), which the bankruptcy court incorporated into its findings of fact. (App. E, 49a).

The predecessor of Sowashee Venture ("Sowashee") acquired a long-term interest in a large tract of land in Meridian, Mississippi in 1971. In 1983, Sowashee leased (the "Ground Lease") a portion of the tract to Austin Development Company (the "Developer"). Using borrowed funds, the Developer built a five-screen motion picture theater on that property. The Developer subleased the property to the predecessor of R & S Theaters, Inc. (the "Movie Theater"), which now operates the theater.

When it subleased the property, the Movie Theater obtained a non-disturbance agreement from Sowashee in order to protect itself against any default by the Developer under the Ground Lease. If the Ground Lease were terminated, the Movie Theater would become Sowashee's

tenant. It would remain in possession of the leased premises and would pay its new landlord, Sowashee, the rent required by the sublease.

More than three years later, the Developer borrowed $850,000 from Eastover Bank for Savings (the "Bank"). The Developer used the borrowed funds to pay off its previous lender and for other purposes. Later, the Developer borrowed additional funds from the Bank. To secure the loans, the Developer gave the Bank a deed of trust on its interest in the Ground Lease with Sowashee. The Developer also assigned to the Bank its interest in the sublease with the Movie Theater.

In early 1987, the Bank notified Sowashee and the Movie Theater of the assignments. Thereafter, the Movie Theater paid its monthly rent of approximately $11,085 directly to the Bank. The Bank then paid Sowashee the monthly rent of approximately $1,500 under the Ground Lease. The Bank escrowed funds for ad valorem taxes and applied the remainder of the monthly payment to the Developer's debt to the Bank.

Those arrangements and the relationships between the parties are illustrated by the Simplified Chart reproduced at Appendix H, 81a. That chart is very similar to one used and adopted by the bankruptcy court.

B. *The Proceedings*

On January 2, 1991, the Developer filed a voluntary petition for reorganization under Chapter 11. During the 60-day period after the filing of that petition, the Developer did not move to accept or reject the Ground Lease;

no one filed a motion with the bankruptcy court to compel the Developer to assume or reject the Ground Lease; and no one moved to extend the 60-day time period provided by section 365(d)(4) of the Bankruptcy Code.

The 60-day statutory period expired on March 4, 1991. On March 28, 1991, Sowashee moved in the bankruptcy court to lift the automatic stay and to require the Developer to vacate the premises immediately. Two months later, Sowashee also filed a complaint to avoid liens and interests and to cancel the liens of the Bank. The Bank filed a counterclaim, asking the bankruptcy court to order Sowashee to enter into a new lease with the Bank.

After a hearing, the bankruptcy court found and ruled for Sowashee in all respects. (App. E, 47a-65a). It concluded that the Ground Lease had been deemed rejected by operation of section 365(d)(4) and had been terminated. (App. E, 53a). It further ruled that the termination of the Ground Lease on March 4, 1991 in turn resulted in the termination and extinguishment of (i) the liens held by the Bank on the Developer's interest in the Ground Lease, (ii) the Developer's interest in the sublease to the Movie Theater, and (iii) the assignment to the Bank of the Developer's interest in that sublease. See October 1, 1991 Order Rejecting and Terminating Lease, Canceling Liens, and Lifting Stay. (App. F, 66a-70a).

The district court affirmed. (App. C, 17a-45a). The court noted that section 365(d)(4) grants a debtor-lessee 60 days in which to assume or reject an unexpired lease of nonresidential real property. If the debtor does not move to accept or reject the unexpired lease within 60 days, the lease is deemed rejected, and under the plain language of

the statute, the debtor is required to immediately surrender the property. The court concluded that the failure of the Developer and the Bank to act on their rights within the 60-day statutory period – coupled with the statute's requirement that the Developer immediately surrender the property to the landlord – caused the Ground Lease between Sowashee and the Developer and the sublease between the Developer and the Movie Theater to terminate. (App. C, 32a-38a).

Recognizing that the question has "generated sharply conflicting opinions among the bankruptcy courts" (App. A, 5a), the court of appeals reversed and remanded. In an opinion by Circuit Judge Edith H. Jones, the court concluded that the Developer's inaction in timely deciding to assume or reject the Ground Lease – which led to a deemed rejection – divested the Developer's bankruptcy estate of any rights in the lease. However, it also concluded the rejection did not terminate the Ground Lease or cause a forfeiture of the rights of third parties to that lease. (App. A, 14a). Because it concluded that the lease did not terminate upon rejection, the court further ruled that the Bank retained its rights against Sowashee as a third party beneficiary of the Ground Lease. *Id.* Finally, the court decided that, because the Developer's bankruptcy estate had no remaining interest in the outcome of the dispute after the lease was rejected, the extent of the Bank's rights should be determined in state court. *Id.*

REASONS FOR GRANTING THE PETITION

This case presents a difficult and recurring question concerning the interpretation of a section of the Bankruptcy Code. The ruling affects commercial landlords, tenants, developers, and the financial institutions which lend to them. The question is one with which the lower courts have wrestled – with clearly differing views – for nearly ten years. A conflict exists among the circuits, and conflicting decisions are proliferating in the district courts and the bankruptcy courts in many other circuits. Guidance from this Court is needed. If this important question is not resolved, bankruptcy proceedings involving debtor-lessees who have unexpired leases will be unduly complicated, and needless additional litigation – with non-uniform outcomes – will result in the state courts.

I. THE COURT OF APPEALS' INTERPRETATION OF 11 U.S.C. § 365(d)(4) CONFLICTS WITH THE NINTH CIRCUIT'S INTERPRETATION AND AGGRAVATES THE EXISTING SPLIT OF AUTHORITY IN THE LOWER COURTS

Subject to court approval, section 365(a) of the Bankruptcy Code provides that the bankruptcy trustee may assume or reject any executory contract or unexpired lease of the debtor. 11 U.S.C. § 365(a). Section 365(d)(4) specifically addresses the situation where the debtor is a *lessee* of an unexpired lease for nonresidential real property. In that situation, the trustee must assume or reject any unexpired lease within 60 days after the date of the filing of the bankruptcy petition. If the trustee does not act within 60 days, the "lease is deemed rejected, and the

trustee shall immediately surrender such nonresidential real property to the lessor." 11 U.S.C. § 365(d)(4).

Section 365(d)(4) was added to the Bankruptcy Code in 1984 as part of the so-called "shopping center amendments" which were part of the Bankruptcy Amendments and Federal Judgeship Act of 1984, Pub. L. No. 98-353, 98 Stat. 333, 363 (1984). Before 1984, there were no fixed deadlines, and a Chapter 11 debtor-lessee did not have to decide whether to assume or reject a lease until a bankruptcy plan of reorganization was approved. This was true even if the debtor had vacated the leased premises and had stopped paying rent. Until plan approval, a landlord in effect was forced to allow the premises to remain vacant in case the debtor-lessee decided to exercise his right to assume the lease.

In 1984, Congress enacted section 365(d)(4) to provide a clear time limit. The statute's primary purpose is to protect lessors from delay and uncertainty by forcing the bankruptcy trustee to decide within 60 days whether to assume unexpired nonresidential real property leases. In addition, by requiring "immediate surrender" after the lapse of 60 days, the statute allows the landlord to seek a replacement tenant. One court has described the statute as "mak[ing] whoever controls the debtor's property put up or shut up within a reasonable time; non-assumption is treated as rejection in order to prevent the lessee from defeating the provision simply by dragging his feet." *In the Matter of James Wilson Associates*, 965 F.2d 160, 169 (7th Cir. 1992). If the trustee does not act within 60 days, the lease is deemed rejected as a matter of law. *In re Pacific-Atlantic Trading Co.*, No. 92-15362, 1994 WL 267945 at *2 (9th Cir. June 20, 1994).

The language of Section 365(d)(4) has been subject to different interpretations. The question is: when there has been rejection and surrender of the premises, what happens to the lease? Two distinct lines of cases have emerged. The first holds that a rejection constitutes termination of the lease and all rights associated with it. The second holds that, although rejection constitutes a breach of the lease, it does not necessarily cause a termination of the lease for all purposes. Under this latter line of cases, some rights in or associated with the lease remain. The second line of cases is illustrated by the court of appeals decision here. (App. A, 1a-14a).

The first line of cases concerning termination is represented by the Ninth Circuit's decision in *Sea Harvest Corp. v. Riviera Land Co.*, 868 F.2d 1077 (9th Cir. 1989). In *Sea Harvest*, a Chapter 11 debtor was the lessee of nonresidential real property leases of tidelands, which were used in clam harvesting operations. The debtor did not properly assume the lease within the 60-day statutory period, and the lease was deemed rejected. Deemed rejection, the debtor argued, was not the same as the termination of the lease. On behalf of a unanimous panel, Circuit Judge Wallace concluded that that argument was without merit. 868 F.2d at 1080. Focusing on the "immediately surrender" language of the statute, the court ruled:

> "Surrender of property, whether its use is for a retail store in a mall or a clam harvesting operation in the tidelands, has the effect of terminating the enterprise that operates there. If Congress intended passive rejection of a lease to be subject to court approval, it would not have required the drastic step of immediate surrender." *Id.*, at 1080-1081.

The court of appeals attempted to distinguish *Sea Harvest*, stating that "the [Sea Harvest] court did *not* say as sometimes suggested, that the effect of § 365(d)(4) was to terminate the lease, but only the 'enterprise' if the debtor is the lessee." (App. A, 9a, n.8). However, that distinction is not meaningful, and the conflict between the circuits is real.

A review of the *Sea Harvest* opinion as a whole – as opposed to just a sentence fragment – makes clear that the court was talking about the termination of the lease. The specific point argued by the Bank in this case was rejected by the Ninth Circuit. The *Sea Harvest* debtor argued that deemed rejection is not the same as termination of the lease. In response, the Ninth Circuit stated that "[a] cursory examination of section 365 immediately reveals that this argument lacks merit." 868 F.2d at 1080. Furthermore, in concluding that the debtor's "appeal. comes close to being frivolous" (*id.*, at 1081), but did not warrant sanctions, the court concluded that:

> "Sea Harvest's argument that 'deemed rejection' does not constitute 'terminated' is wholly without merit and contrary to the plain language of 11 U.S.C. § 365." *Id.*

Sea Harvest's use of the phrase "terminating the enterprise that operates there," refers to the end of the business activities taking place on the premises, *i.e.*, the harvesting of clams, by virtue of the lease. That enterprise would end as the result of the termination of the lease. No other conclusion makes sense in the context of the opinion. Certainly the "terminating the enterprise" phrase could not reasonably be read to mean that the jural status or corporate existence of the Sea Harvest

Corporation was being terminated. Nothing in section 365(d)(4) – or anywhere else in the Bankruptcy Code – envisions such a result or confers such a power. There can be little doubt that the Ninth Circuit concluded that rejection plus immediate surrender results in termination of the lease.

In short, if the undisputed facts in this case – as embodied by the Stipulation agreed to by the parties in the bankruptcy court (App. G, 71a-80a) – were presented to a panel of the Ninth Circuit, the decision in this case would be different. The Fifth Circuit and the Ninth Circuit are in direct conflict.

In addition, the Third Circuit has affirmed, without a published opinion, a district court opinion adopting the view that rejection results in termination of the lease. In a case with facts similar to those here, the District Court for the District of Delaware – a jurisdiction that frequently hears large bankruptcy cases – held that "when a lease is deemed rejected pursuant to § 365(d)(4), any subleases under that primary lease must also be deemed rejected since the sublessee's rights in the property extinguish with those of the sublessor." *Chatlos Systems, Inc. v. Kaplan*, 147 B.R. 96, 100 (D. Del. 1992), *aff'd without opinion*, 998 F.2d 1005 (3d Cir. 1993). In so ruling, the district court stated:

> "Rejection of a non-residential lease results in termination of the lease. Once the underlying lease is terminated, leasehold mortgagees or sublessees retain no interest that can be pursued in bankruptcy court or state court.

> The surrender remedy specially provided in § 365(d)(4) by Congress embodies a federal policy to ensure that unless extended by the Court, landlords obtain possession of their property within sixty (60) days of the filing if the lease is not assumed. It would be contrary to this policy to allow mortgagees or sublessees whose rights are derived solely from a debtor's interest as direct lessee to continue to tie up the property with litigation in bankruptcy court or in state court."

147 B.R. at 98, quoting *In re 6177 Realty Associates, Inc.*, 142 B.R. 1017, 1019 (Bankr. S.D. Fla. 1992). While the Third Circuit does not cite its unpublished opinions as authority, its decision demonstrates the existence of a conflict among the circuits. See R. Stern *et al.*, *Supreme Court Practice*, § 4.8, at 180 (7th ed. 1993) (appellate summary affirmance without opinion establishes conflict).

In addition to the conflicting court of appeals decisions, the issue has caused ample disarray in the lower courts, which have repeatedly grappled with this issue. Numerous reported decisions with differing outcomes have resulted. Numerous courts adhere to the view that rejection plus immediate surrender causes the termination of the lease.[2] Others adopt the view that rejection

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[2] *In re Mr. Gatti's Inc.*, 162 B.R. 1004 (Bankr. W.D. Tex. 1994) (recognized by the court of appeals here as "[a] particularly thoughtful bankruptcy court opinion" (App. A, 10a, n.9), but not followed with respect to the termination issue); *Chatlos Systems, Inc. v. Kaplan*, 147 B.R. 96 (D. Del. 1992), *aff'd without opinion*, 998 F.2d 1005 (3d Cir. 1993); *In re 6177 Realty Associates, Inc.*, 142 B.R. 1017 (Bankr. S.D. Fla. 1992); *In re Child World, Inc.*, 142 B.R. 87 (Bankr. S.D.N.Y. 1992); *In re J.T. Moran Financial*

occasions only a breach, and interests in the lease may remain.[3] The conflicting authority is acknowledged by practitioners, including in an article discussing a landlord's remedies after rejection:

> "It is apparent, and acknowledged by almost every court writing on the subject, that there is a split of authority concerning the status of either a ground lease or security interest therein once the lessee rejects the lease. However, the overwhelming majority of courts faced with the specific question of whether a mortgagee's interest is terminated by the rejection of a ground lease under Code § 365 have held that rejection equals termination." R.F. Casher *et al.*, *Leasehold Mortgage and Bankruptcy: Look Before*

Corp., 124 B.R. 924 (Bankr. S.D.N.Y. 1991); *In re Stalter & Co. Ltd.*, 99 B.R. 327 (E.D. La. 1989); *In re Giles Associates, Ltd.*, 92 B.R. 695 (Bankr. W.D. Tex. 1988); *In re Gillis*, 92 B.R. 461 (Bankr. D. Haw. 1988); *In re Dial-A-Tire, Inc.*, 78 B.R. 13 (Bankr. W.D.N.Y. 1987); *In re Southwest Aircraft Services*, 66 B.R. 121 (Bankr. 9th Cir. 1986), *rev'd on other grounds*, 831 F.2d 848 (9th Cir. 1987), *cert. denied*, 487 U.S. 1206 (1988); *In re Bernard*, 69 B.R. 13 (Bankr. D. Haw. 1986); *In re Hawaii Dimensions, Inc.*, 39 B.R. 606 (Bankr. D. Haw. 1984), *aff'd*, 47 B.R. 425 (Bankr. D. Haw. 1985). *See In re Southern Motel Associates*, 81 B.R. 112, 118 (Bankr. M.D. Fla. 1987) (compliance with § 365(d)(4) not excused, even if it results in forfeiture of substantial assets).

[3] *In re Emple Knitting Mills, Inc.*, 123 B.R. 688 (Bankr. D. Me. 1991); *In re Blackburn*, 88 B.R. 273 (Bankr. S.D. Cal. 1988); *Societe Nationale Algerienne Pour la Recherche v. Distrigas Corp.*, 80 B.R. 606 (D. Mass. 1987); *In re Picnic 'N Chicken, Inc.*, 58 B.R. 523 (Bankr. S.D. Cal. 1986); *In re Storage Technology Corp.*, 53 B.R. 471 (Bankr. D. Colo. 1985); *Cf. In re Norton*, 112 B.R. 932 (C.D. Ill. 1990) (acknowledging conflict); *In re Miller*, 103 B.R. 353 (Bankr. D.D.C. 1989) (acknowledging both lines of cases but not clearly adopting either view).

You Leasehold, 390 PLI/Real Estate Workouts and Bankruptcies 151, 207-208 (1993).

There is no realistic prospect for the resolution of this conflict without a decision by this Court. Additional decisions from other courts of appeals will not aid the matter. Future appellate decisions simply will weigh in on one side of the question or the other without resolving this significant conflict. The courts need guidance on this important issue of federal law now, and this Court should grant certiorari to resolve this conflict.

II. THE FIFTH CIRCUIT'S DECISION CREATES UNCERTAINTY, IMPEDES BANKRUPTCY REORGANIZATIONS, AND FRUSTRATES IMPORTANT POLICIES UNDERLYING THE BANKRUPTCY CODE

Congress enacted section 365(d)(4) in 1984 to force bankruptcy trustees and debtors-in-possession to act to assume or reject nonresidential property leases where the debtor is the tenant. Before section 365(d)(4), the Chapter 11 debtor could wait until plan confirmation before making the election. This was true even when the debtor had vacated the premises, forcing the landlord to leave the property unoccupied until the lessee decided to assume or reject the lease. *See In the Matter of James Wilson Associates*, 965 F.2d at 168-169, citing *In the Matter of American Healthcare Management, Inc.*, 900 F.2d 827, 830 (5th Cir. 1990). Section 365(d)(4) was intended to provide an escape from the limbo of unassumed, but assumable leases.

A. **Uncertainty.** By characterizing rejection and surrender only as a "breach" rather than a "termination," (App. A, 14a), the court of appeals places the landlord (and the bankruptcy case itself) in the same limbo that the 1984 amendments intended to eliminate. Although the opinion recognizes that section 365(d)(4) means that the debtor's obligations under the lease are over and that the debtor must immediately leave the premises, the refusal to treat the lease as terminated frustrates the purposes of the statute.

Reading the statute, a landlord would reasonably infer that the failure of a debtor to act under section 365(d)(4) allows the landlord to immediately relet the premises. After all, the old lease has been rejected, and the debtor must vacate the property. Also, payments by a new tenant will mitigate the landlord's damages. That benefits the landlord, the debtor, and the debtor's creditors. But, if the landlord executes a new lease with a new tenant, and the new tenant takes possession of the premises, a creditor may later appear claiming a lien or other interest in the original, rejected leasehold. This can occur because, under the court of appeals' view, the original lease is merely in breach and not necessarily over. In its view, notwithstanding rejection and surrender, the old lease was not "terminated."

By so characterizing the status of the lease, the court of appeals puts the landlord (and the bankruptcy case) in a never-never land – a situation worse than the limbo situation that the statute was enacted to cure: (1) a lease is rejected under section 365(d)(4); (2) the trustee immediately surrenders the property to the landlord; (3) the landlord finds a new tenant who signs a new lease and

occupies the space; then, (4) a lienholder appears, claiming an interest in the rejected lease. At that point, the rights of all concerned are uncertain.

The decision places all landlords in a quandary. Should a landlord relet the premises and run the risk of future litigation with the old tenant, the new tenant, and the lienholder? Or should it allow the property to remain vacant? The statute was enacted to allow a landlord to relet the premises. Yet, the landlord would not be able to guarantee to any new tenant a key element of a leasehold, quiet enjoyment. In practice, the landlord cannot relet the premises to a new tenant until it goes to state court and litigates with the lender over the lender's rights under the "rejected" and "breached" – but not yet "terminated" – lease. The premises must remain vacant until such time as the lender's rights are adjudicated in some other forum. Thus, the court of appeals' approach is contrary to the policy underlying section 365(d)(4), because it allows the debtor or the lender "to continue to tie up the property with litigation. . . . " *Chatlos Systems, Inc.*, 147 B.R. at 98.

B. **Adverse Effects on Bankruptcy Reorganizations.** The court of appeals' decision also will result in delays and tremendous inefficiencies in the bankruptcy reorganization process. A fundamental policy underlying Chapter 11 of the Bankruptcy Code is the promotion of rapid, efficient, and successful reorganization of debtors. *See* H.R. Rep. No. 594, 95th Cong. 2d Sess. 5 (1977), *reprinted in* 1978 U.S.C.C.A.N. 5963, 5966. Further, in enacting section 365(d)(4) in 1984, Congress wished to provide certainty and end delay. Swift administration of the bankruptcy estate (which has the lease as an asset)

was of paramount importance. *See In the Matter of James Wilson Associates*, 965 F.2d at 169. Yet, by leaving the issue of termination unresolved, the court of appeals' decision inevitably will lead to additional and needless litigation in the state courts. Swift administration of bankruptcy cases will not be possible.

In a bankruptcy case, a debtor – like a landlord – needs finality and resolution of lease obligations. If the landlord can procure a replacement tenant, its claims against the debtor's bankruptcy estate are mitigated and may even vanish. Even if there were no new tenant, the claims would be fixed, and the bankruptcy case can proceed. However, under the Fifth Circuit's view, the claims of the landlord and the lender remain indeterminate. In order to resolve those claims, the parties must go to state court. This supposes the filing of an action, an answer, discovery, a trial, and any appeals. Months or even years may pass before there is a resolution of the claims. Until then, there is no meaningful way to go forward with a plan of reorganization. The bankruptcy case remains adrift. The debtor and its creditors cannot wrap up the bankruptcy case and consummate a plan until the completion of those state proceedings.

Further, requiring state court litigation concerning leases which have been deemed rejected by operation of federal law is inconsistent with the language and policies underlying the Bankruptcy Code. Instead of a uniform rule existing under federal bankruptcy law regarding the termination of rejected leases, the rights associated with every lease that is deemed rejected under section 365(d)(4) are left to state judges and chancellors under the different laws of the 50 states.

C. **Frustration of Legislative Intent.** The legislative history shows that Congress passed section 365(d)(4) to insure immediate action where a lessee of nonresidential real property filed for bankruptcy. *Bankruptcy: The Shopping Center Protection Improvement Act of 1982: Hearing on S. 2297 Before the Subcomm. on Courts of the Senate Comm. on the Judiciary*, 97th Cong., 2d Sess. 80 (1982). *See In the Matter of American Healthcare Management, Inc.*, 900 F.2d at 830 ("delay and uncertainty [were what] Congress sought to eliminate in enacting section 365(d)(4)"). Congress intended that section 365(d)(4) would cause the property to revert to the landlord and thus permit the landlord to relet the premises. Congress also sought to establish a uniform rule in bankruptcy proceedings in order to protect landlords of nonresidential real property from the impact of a tenant's bankruptcy and from any significant delay in assumption or rejection. *Hearing (1982)* at 80. Congress heard testimony that the statute would allow immediate reletting of the premises if "deemed rejection" occurred (*id.*) and concluded that it was appropriate for the premises to revert to the landlord. S. Rep. No. 527, 97th Cong. 2d Sess. 16 (1982).

Despite the language of the statute and its legislative history, the court of appeals still apparently believed that the consequences to the Bank of the Developer's missing the 60-day deadline were too harsh. (App A, 13a). Before it enacted the statute, Congress explicitly considered that in some instances allowing the landlord to recapture the original lease might be inequitable and the operation of section 365(d)(4) would result in a potential windfall to the landlord. *Bankruptcy Reform: Hearing Before the Subcomm. on Courts of the Senate Comm. on the Judiciary*, 98th

Cong., 1st Sess. 551 (1983). Nevertheless, Congress enacted the statute as proposed, apparently viewing those potential inequities as a necessary price to pay for the action-forcing mechanism inherent in the 60-day deadline. Moreover, courts agree that a statute which imposes deadlines must be obeyed: "Deadlines may lead to unwelcome results, but they prompt parties to act and they produce finality." *Taylor v. Freeland & Kronz*, ___ U.S. ___, 112 S. Ct. 1644, 1648 (1992).

D. **Rejection is Termination.** To further justify its interpretation of both section 365(d)(4) and the underlying legislative intent, the court of appeals makes much of the argument that Congress understood the difference between the words "reject" and "terminate." The opinion contrasts the use of the word "terminated" in sections 365(h), (i), and (n) with the use of the term "rejection" in section 365(d). (App. A, 11a-13a). However, those subsections deal with situations where the debtor is the *lessor*, seller, or licensor of an interest in the debtor's property. Those sections have nothing to do with situations – like in this case – where the debtor is the *lessee* of someone else's nonresidential real property.

Moreover, even if one looks to section 365(h)(1), that section shows that Congress actually considered rejection to result in termination: "If the trustee rejects an unexpired lease of real property of the debtor . . . the lessee . . . may treat such lease . . . as terminated by such rejection, where the disaffirmance . . . amounts to such a breach as would entitle the lessee . . . to treat such lease . . . as terminated by virtue of its own terms, applicable nonbankruptcy law, or other agreements . . .

or, in the alternative, the lessee . . . may remain in possession. . . . " 11 U.S.C. § 365(h)(1).

Because rejection of the debtor's obligations as lessee would generally terminate a lease, Congress felt it necessary to establish a different policy for situations in which the debtor is the *lessor* and thus wrote section 365 to protect lessees. Section 365 consistently refuses to allow the debtor to unilaterally avoid a pre-petition interest granted to a third party, whether that interest is a lease, an executory license, or a timeshare agreement. As matter of policy, third parties using the debtor's property in those situations are allowed to ignore the debtor's act of rejection, remain in possession, and continue to perform under the original contractual agreement. Alternatively, those persons are permitted to treat the debtor's rejection as termination and file a claim for the damages resulting from the breach.

On the other hand, where the debtor is in possession of a property of a third person as *lessee*, rejection is a unilateral act subject to court approval (*see* Fed. R. Bankr. P. 6006(a)) or to the deemed rejection provision of section 365(d)(4). *See Sea Harvest*, 868 F.2d at 1079-1081.

E. **Neither Avoidance nor Forfeiture.** Finally, in further support its analysis that section 365(d)(4) does not terminate a lease, the court of appeals stated that bankruptcy policy would not permit that section 365(d)(4) to operate as a lien avoidance provision. (App. A, 13a-14a). The avoidance provisions of the Bankruptcy Code, which are primarily 11 U.S.C. §§ 544, 547, and 548, allow a debtor to avoid various types of transfers of the debtor's property to third persons. Certainly, section 365(d)(4) is

not an avoidance provision. It does not act to undo the debtor's transfer of a lien in its property.

Instead, section 365(d)(4) operates to terminate a debtor's interest in the property of another person, *i.e.*, the landlord. If the lease is terminated by section 365(d)(4), the lien is not avoided or forfeited. (App. A, 12a). Rather, the debtor's property interest in the leasehold is lost. Any lien on the debtor's property becomes valueless because the lien no longer attaches to anything that the debtor owns. *See In re Stalter & Co.*, 99 B.R. at 331. This is not avoidance. By analogy, if a lender takes a lien on real property, and the debtor's title to that real property is later found to be defective, one would not characterize the lien as having been avoided. The lien simply would not be worth anything because the debtor held no title to the collateral.

CONCLUSION

The Petition for Writ of Certiorari should be granted.

Respectfully submitted,

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July 28, 1994

APPENDIX A

In the Matter of
AUSTIN DEVELOPMENT COMPANY, Debtor.

EASTOVER BANK FOR SAVINGS, Appellant,

v.

SOWASHEE VENTURE, et al., Appellees,

v.

AUSTIN DEVELOPMENT COMPANY and J.C. Bell, Trustee, Appellants.

No. 93-7127.

United States Court of Appeals,
Fifth Circuit.

May 3, 1994.

Lessor under ground lease with Chapter 11 debtor filed motion and complaint requesting termination of debtor's interest as lessee in ground lease, of bank's deed of trust on debtor's leasehold interest, and of bank's interest in debtor's sublease for movie theater built on leased property. The United States Bankruptcy Court for the Southern District of Mississippi found for lessor and against bank, and appeal was taken. The District Court, Henry T. Wingate, J., affirmed, and bank appealed. The Court of Appeals, Edith H. Jones, Circuit Judge, held that: (1) debtor's inaction in timely deciding to assume or reject lease of nonresidential real property, which leads to deemed rejection, does not effect termination of that lease or implied forfeiture of rights of third parties to lease; (2) following deemed rejection of debtor's ground lease, the bank, which had been granted deed of trust on debtor's

tenant-leasehold interest, retained rights in lease against lessor as third-party beneficiary of lease; and (3) controversy regarding extent of bank's rights as third-party beneficiary of lease was not "related to" bankruptcy as required for federal jurisdiction.

Reversed and remanded.

Pat H. Scanlon, John S. Simpson, Young, Scanlon & Sessum, Jackson, MS, for appellant.

Thomas E. Schwartz, Hattiesburg, MS, for Bell.

Thomas L. Webb, Bourdeaux & Jones, Meridian, MS, for Sowashee Venture.

Robert H. Compton, Witherspoon & Compton, Meridian, MS, for R & S Theaters, Inc.

P. Scott Phillips, William & Glover, Meridian, MS, for United Artists.

Appeal from the United States District Court for the Southern District of Mississippi.

Before HIGGINBOTHAM, DAVIS, and JONES, Circuit Judges.

EDITH H. JONES, Circuit Judge:

The debtor was a lessee under a ground lease and sublessor of a movie theater it built; it assigned its interest in the ground lease and the theater's income stream to a bank as security for various loans. During its Chapter 11 proceeding, the debtor's inaction led to an automatic

rejection of its ground lease. 11 U.S.C. § 365(d)(4).[1] The district court and bankruptcy court held that the "deemed rejection" of the lease effected the termination of the bank's rights under the ground lease and the bank's assignment of the theater sublease.[2] We reverse and remand.

BACKGROUND

The facts in this case are straightforward. Austin Development Company (Austin) entered into a long-term ground lease from the predecessor of Sowashee Venture, a general partnership (Sowashee). After borrowing funds from another bank and building a motion picture theater on the property, Austin subleased the property to the predecessor of R & S Theaters, Inc. (R & S), the theater's current operator. Austin borrowed money from Eastover Bank for Savings (Eastover) to pay off its first lender and for other purposes in 1986. As security for the Eastover loans, Austin granted Eastover a deed of trust on its

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[1] 11 U.S.C. § 365(d)(4) reads:

> [I]f the trustee does not assume or reject an unexpired lease of nonresidential real property under which the debtor is the lessee within 60 days after the date of the order for relief, or within such additional time as the court, for cause, within such 60-day period, fixes, then such lease is deemed rejected, and the trustee shall immediately surrender such nonresidential real property to the lessor.

[2] The theater obtained a nondisturbance agreement with Sowashee, and its lease remained in place notwithstanding Austin's Chapter 11 proceeding. We do not need to consider the impact of § 365(d)(4) on the theater's sublease from the debtor.

tenant-leasehold interest in the ground lease fro
Sowashee and an assignment of Austin's interest in th
sublease to R & S. Before Austin's bankruptcy, R & S pai
about $11,085 in monthly rental and taxes directly
Eastover. Eastover then applied about $9,000 of this sub
lease payment to Austin's debt, paid Sowashee abou
$1,500 as monthly rent under the ground lease, an
escrowed money for ad valorem taxes.

On January 2, 1991 Austin filed for reorganizatio
under Chapter 11. Austin did not assume that Sowashe
ground lease within 60 days after it filed its bankruptc
petition, nor did Eastover file a motion to compel Austi
to assume or reject. Sowashee thereupon filed a motio
and complaint requesting that the bankruptcy court te
minate 1) Austin's interest as lessee in the ground leas
2) Eastover's deed of trust on Austin's leasehold interes
and 3) Eastover's interest in the sublease with R &
Eastover's counterclaim asked the bankruptcy court
order Sowashee to enter into a ground lease with Eas
over, as provided for under paragraph 21 of the groun
lease. That lengthy "paragraph" granted Austin permis
sion to mortgage all or part of its leasehold estate an
granted any future leasehold mortgagee numerous right
as a third-party beneficiary of the ground lease. Thes
creditor rights, similar to those found in nondisturbanc
agreements between landlords and leasehold mortgagee
included: 1) a requirement that the parties to the groun
lease obtain the leasehold mortgagee's written conse
prior to cancellation, surrender, or modification of th
ground lease; 2) the right to cure lessee's defaults; 3) th
right, if termination were to be declared by the landlor
to nullify the termination or indefinitely postpone it b

curing all conditions of default; and 4) the right, if termination were to be realized, of the leasehold mortgagee to enter into a new lease with the landlord on the same terms as the terminated lease.

The bankruptcy court found for Sowashee and against Eastover in all respects. It ruled that § 365(d)(4) of the Bankruptcy Code did not result in a breach, but rather a termination of the ground lease, the termination of Eastover's interest in the sublease payments, and the termination of Eastover's rights under the ground lease as a third-party beneficiary. The district court affirmed.

DISCUSSION

The question presented in this case is what it means when a debtor as a lessee of nonresidential real property fails within 60 days after filing a Chapter 11 case to assume an unexpired lease. Under § 365(d)(4) of the Bankruptcy Code, the lease is "deemed rejected." Does the rejection terminate the lease and thus extinguish a security interest taken in the debtor's interest in the lease, and sublease by the debtor-lessee, or similar rights that accrued by and among third parties?

This question, although arising infrequently, has generated starkly conflicting opinions among the bankruptcy courts.[3] The bankruptcy and district courts here relied

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[3] *Compare In re Gillis*, 92 B.R. 461 (Bankr.D.Haw.1988); *In re Giles Assocs. Ltd.*, 92 B.R. 695 (Bankr.W.D.Tex.1988); *Chatlos Sys., Inc. v. Kaplan*, 147 B.R. 96 (D.Del.1992), *aff'd without opinion*, 998 F.2d 1005 (3d Cir.1993) (having no precedential value, however, under Internal Operating Procedures of the Third Circuit, IOP

upon the line of cases that construe rejection under § 365(d)(4) essentially as an avoiding power against such holders of security interests in the debtor's leases.[4] Those cases deduce that when a lease is "deemed rejected," the further requirement of § 365(d)(4) that the trustee "shall immediately surrender such nonresidential real property to the lessor" effects a termination of the lease. Under these cases, the lease is terminated by operation of federal law and not because of any breach of its terms. They conclude that when the lease terminates, security interests in the lease are extinguished. *See In re Giles Associates, Ltd.*, 92 B.R. 695 (Bankr. W.D.Tex.1988). Somewhat inconsistently, these courts also state that if the lienholders had come into court within the 60-day period for assumption or rejection of nonresidential real property leases, they could have avoided the dire consequences of "deemed rejection." Precisely how the lienholders, such as Eastover, could have protected themselves is not explained

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5.6, *reprinted at* 28 U.S.C.A. Rules, Part I (West Supp.1993)); *In re Hawaii Dimensions, Inc.*, 39 B.R. 606 (Bankr.D.Haw.1984), *aff'd* 47 B.R. 425 (D.Haw.1985) *with In re Storage Technology Corp.*, 53 B.R. 471 (Bankr.D.Colo.1985); *In re Picnic 'N Chicken, Inc.*, 58 B.R. 523 (Bankr.S.D.Cal.1986); *Societe Nationale Algerienne Pour la Recherche v. Distrigas Corp.*, 80 B.R. 606, 608-09 (D.Mass.1987); *In re Blackburn*, 88 B.R. 273, 276 (Bankr.S.D.Cal.1988). *See generally* William E. Winfield, *Rejection of Nonresidential Leases of Real Property in Bankruptcy: What Happens to the Mortgagee's Security Interest?*, 17 Pepp.L.Rev. 429 (1990).

[4] *See, e.g., In re Gillis; In re Giles Assocs., Ltd.; In re Hawaii Dimensions, Inc.; Chatlos Sys., Inc. v. Kaplan* – all cited *supra* note 3.

and is highly problematic.[5] These opinions circularly conclude that the statutory breach plus surrender provided in § 365(d)(4) must cause a termination of the trustee's or debtor-in-possession's rights in the leasehold, because otherwise, "the face of the statute and its history are meaningless."[6] *In re Giles*, 92 B.R. at 698.

Flawed by their failure to analyze § 365(d)(4) in harmony with the rest of § 365 and applicable statutory antecedents, these opinions have worked needless and perhaps unconstitutional forfeitures of security interests. This court's interpretation relies instead on those cases that have construed the plain meaning of § 365, understood in light of all its terms, which together express the

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[5] If the debtor had the unfettered right to assume or reject within 60 days, it is hard to see how the leasehold mortgagee could, by moving within that period to compel the debtor to act, assure itself of protection. One court held that the mortgagee's protection lies in a § 554 motion to compel the trustee (or debtor-in-possession) to abandon the leasehold, which would leave all parties to fight out their relationships in the state court. *In re Bernard*, 69 B.R. 13 (Bankr.D.Haw.1986). This prescription seems unnecessarily contrived as compared with our straightforward reading of § 365(d)(4).

[6] Contrary to the statement in *Giles* and similar ones by other courts, legislative history provides very little guidance for the interpretation of the effect of § 365(d)(4) on mortgagees of a debtor's leasehold. It is true that § 365(d)(4) is part of the 1984 "shopping center" amendments to the Bankruptcy Code and that it sought to lessen the vacancy period for lessors to debtors in such cases by requiring a firm 60-day assume/reject decision. *See In re Giles*, 92 B.R. at 697. This goal of protecting lessors does not conflict with the protection of leasehold mortgagee's rights, however, because a mortgagee would have to comply with the lease in order to take it over from the debtor. The lessor would have to be satisfied.

Congressional purpose behind the trustee's assumptio and rejection power.[7] *Toibb v. Radloff*, 501 U.S. 157, __ 111 S.Ct. 2197, 2199-2200, 115 L.Ed.2d 145 (1991). Sectio 365 derives from § 70(b) of the former Bankruptcy Act, provision that broadly codified the common law doctri that allowed the trustee either to assume and perform th debtor's leases or executory contracts or to "reject" the if they were economically burdensome to the estate. *S generally* Michael T. Andrew, *Executory Contracts in Ban ruptcy; Understanding "Rejection,"* 59 U of Colo.L.Rev. 84 874-81 and n. 136 (1988). This court has held that th deemed rejection of a lease under § 70(b) did not term nate the lease but merely placed the trustee's obligatio to perform under the leasehold outside of the bankrupt administration without destroying the leasehold estate. *re Garfinkle*, 577 F.2d 901, 904 (5th Cir.1978). Cons quently, on facts similar to those in the instant cas *Garfinkle* held that the mortgage of the original less from whom the bankrupt acquired the leasehold w preserved notwithstanding an attempted rejection. *Garfinkle*'s analysis remains persuasive, as § 70(b) an § 365(d)(4) do not materially differ in any way tha effectuate the assumption and rejection power. *See In Storage Technology Corp.*, 53 B.R. 471, 47 (Bankr.D.Colo.1985); Andrew, *supra*, 59 U.Colo.L.Rev. 879 and nn. 136-140.

Turning to § 365, the terms rejection, breach an termination are used differently, but not inconsistently

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[7] *See, e.g., Societe Nationale Algerienne Pour la Recherche Distrigas Corp.; In re Storage Technology Corp.; In re Picnic Chicken* – all cited *supra* note 3.

interchangeably, as some courts have suggested. *See, e.g., In re Giles*, 92 B.R. at 698. Throughout § 365, rejection refers to the debtor's decision *not to assume* a burdensome lease or executory contract. Section 365(g) states that rejection of a lease "constitutes a breach" except as provided in subsections (h)(2) and (i)(2). Three circuits, including this one, have held that this language does not mean the executory contract or lease has been terminated, but only that a breach has been deemed to occur. *In re Continental Airlines*, 981 F.2d 1450, 1459 (5th Cir. 1993) ("to assert that a contract effectively does not exist as of the date of rejection is inconsistent with deeming the same contract breached"); *In re Modern Textile, Inc.*, 900 F.2d 1184, 1191 (8th Cir.1990); *Leasing Service Corp. v. First Tennessee Bank, Nat'l Ass'n*, 826 F.2d 434, 436-37 (6th Cir.1987)[8] Consistent with this interpretation, § 502(g) permits the creditor on a rejected lease or executory contract to assert a claim for damages as of the date of bankruptcy, although under § 502(b)(6) a landlord's claim

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[8] In *Wainer v. A.J. Equities, Ltd.*, 984 F.2d 679, 684 (5th Cir.1993), this court opined that under § 365, a debtor-tenant "can reject the lease, which is then terminated. . . . " That statement is immaterial to the court's discussion and holding in *Wainer*, is inconsistent with *Matter of Continental Airlines, supra*, and *Matter of Garfinkle, supra*, and has no precedential effect. Likewise, in *Sea Harvest Corp. v. Riviera Land Co.*, 868 F.2d 1077, 1080-81 (9th Cir.1989), the court stated that, "Surrender of property, whether its use is for a retail store in a mall or a clam harvesting operation in the tidelands, has the effect of terminating the enterprise that operates there." The court did *not* say as is sometimes suggested, that the effect of § 365(d)(4) was to terminate the lease, but only the "enterprise" if the debtor is the lessee.

may be subject to a cap.[9] Rejection is treated as a brea to preserve the rights of the party whose lease with t debtor has been rejected by providing a prepetition clai if rejection were deemed a complete, immediate termin tion, it is not clear what the measure of the creditor claim would be.

The decision to reject is thus correctly viewed only a "power to breach" the executory contract or lease. A one commentator put it:

> [w]hat the estate's representative is rejecting is the contract or lease *asset*, which conceivably could carry continuing obligations with it into the estate on an administrative basis. Rejection simply prevents the *estate* from unadvisedly stepping into such liabilities. The liabilities are not repudiated; to the contrary, as the rejection-as-breach doctrine is designed to insure, the contract or lease liabilities remain intact after

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[9] A particularly thoughtful bankruptcy court opinio recently concluded that under 11 U.S.C. § 502(b)(6), all of landlord's damages arising from the rejection of the debtor lease, including those based on a covenant to repair, are capp by that provision. *In re Mr. Gatti's, Inc.*, 162 B.R. 10 (Bankr.W.D.Tex.1994). The landlord argued that the cap plain encompassed only "damages resulting from the termin tion . . . ," § 506(b)(2), a phrase that appears to exclude "cons quential" damages. The bankruptcy court, rejecting t landlord's argument, first adopted the decision cited *supra* n. which equate rejection with termination. Alternatively, pointed out that even if those decisions are not followed, t landlord's claim is one "against the estate" in bankruptcy base on the debtor's breach. The precise scope of § 502(b)(6) is n before this court; while our reasoning does not agree with t first rationale asserted in *Mr. Gatti's*, the second rational mig easily be reconciled to this case.

> rejection and give the non-debtor party a claim in the distribution of the estate.

Andrew, *supra* at 883 (footnote omitted).

Further, Congress knew how to authorize the termination of executory contracts and leases in § 365. "Termination" is used in § 365(h), (i), and (n) as one option available respectively to the purchaser of an interest in a timeshare project, the vendee of real property, or the licensee from the debtor of a right to intellectual property *if* the trustee has rejected the executory contract. Accordingly, the trustee may reject any of these contracts, but termination does not occur except at the other party's option. The option to terminate a timeshare lease, § 365(h)(1), or a license, § 365(n)(1)(A), arises where the trustee's rejection "amounts to such a breach as would entitle the [party] to treat such lease or [contract] as terminated by virtue of its own terms, applicable nonbankruptcy law, or other agreements. . . . " 11 U.S.C. § 365(h)(1) and § 365(n)(1). In § 365(h)(1), rejection is used synonymously with "disaffirmance" for these purposes; in none of these subsections is rejection or disaffirmance equated with termination. Under an objective reading, the provisions of § 365 may be redundant and complex, but Congress was not confused in its differing usages of the terms rejection, breach and termination.

It is also worth pointing out, as several courts have done, that breach and termination of leases or executory contracts are not synonymous terms under state law. *See e.g., In re Storage Technology, supra; In re Picnic 'N Chicken, Inc.*, 58 B.R. 523, 525 (Bankr.S.D.Cal.1986) (California law); *Resolution Trust Corp. v. Cramer*, 6 F.3d 1102, 1108

(5th Cir.1993) (describing options available to landlor under Texas law). Congress could have chosen to depa from the state law meanings of these terms, but taken as whole, § 365 suggests that it did not do so.

The cases that equate rejection with lease terminatio under § 365(d)(4) ultimately rest on a manufactured def nition of termination as "breach plus surrender of th premises." Thus, the breach caused by the trustee's fai ure to assume or reject the lease within 60 days is "s serious" that § 365(d)(4) requires the debtor to surrend the leased premises immediately, and the breach plu surrender "can only be seen" as a termination of th trustee's rights. *In re Giles*, 92 B.R. at 698. Contrary to th line of reasoning, the word "termination" does no appear in § 365(d)(4). Moreover, that a lease is "deeme rejected" in § 365(d)(4) cannot uniquely cause it to b "terminated," when no such consequence follows "deemed rejection" in § 365(d)(1), and termination pr cedes a "deemed rejction" under the terms of § 365(d)((providing that an air carrier's lease of an aircraft term nal or gate may be "deemed rejected" five days *after* th occurrence of a "termination event"). Section 365 offe no textual support for equating "breach plus surrende with "termination"; to the contrary, it furnishes goo reasons for deducing that Congress did not collap breach or rejection into the termination of a lease executory contract.

If, notwithstanding the foregoing discussion, § 365(d)(4) deemed rejection of a lease or executory co tract automatically brings about its termination, it

peculiar that the most adverse consequences of that statutory interpretation are reserved not for the lessor or lessee – either of which may be the party opposite the debtor – but for the third-party mortgagee whose rights have been held forfeited by operation of law. This result has no policy rationale within the scope of § 365's adjustment of rights between the parties to the lease. Moreover, it is a capricious result that makes no bankruptcy sense. While the Bankruptcy Code expressly authorizes avoidance of certain liens and other preferential rights against the debtor, *see, e.g.*, 11 U.S.C. §§ 544, 547 and 548, the avoidance power read into § 365 is, uncharacteristically, an implied authority. *See* Andrew, *supra*, 59 U.Colo.L.Rev. at 901-02. Moreover, the trustee's avoidance powers may ordinarily be exercised only by means of an adversary proceeding, with its attendant procedural protections, whereas the § 365(d)(4) "forfeitures" of security interests have occurred automatically, by operation of law, without procedural protections. Finally, in eliminating the rights of a mortgagee of the debtor-lessee's interest in a lease, the policies justifying avoidance – to enhance the pot of unencumbered assets available to creditors and to discourage a race to the courthouse before bankruptcy – have not been served. The only rights affected by this implied avoidance power are outside of the bankruptcy court's realm because after rejection, the debtor's estate is no longer involved in the leasehold transaction. This extraordinary implied power does not reduce claims against the debtor's estate; if anything, it increases the unsecured claims by the amount of the mortgagee's claim in the "terminated" lease.

For these reasons, we conclude that a debtor's inaction in timely deciding to assume or reject a lease of nonresidential real property under § 365(d)(4), which leads to a deemed rejection, does not effect a termination of that lease, or, consequently, an implied forfeiture of the rights of third parties to the lease.

As applied to the case at hand, § 365(d)(4) stipulates that when Austin failed timely to assume or reject its lease from Sowashee, the lease was breached and Austin was required to surrender the premises. Sowashee became entitled to file a proof of claim based on a "breach" effective immediately before Austin's bankruptcy. 11 U.S.C. § 502(g). Sowashee was also entitled to receive rent from the filing of bankruptcy to the date of lease rejection. 11 U.S.C. § 365(d)(3).

Because the lease did not terminate upon its deemed rejection, Eastover retained rights in it against Sowashee as a third-party beneficiary of ¶ 21 of the Austin-Sowashee lease. The extent of Eastover's rights, an issue not adjudicated below, should be decided in state court, because after rejection the debtor's estate had no remaining interest in the outcome of that controversy, which is not "related to" the bankruptcy as is required for federal jurisdiction. 28 U.S.C. § 1334(b).

CONCLUSION

The judgments of the district and bankruptcy courts are REVERSED and the case is REMANDED for further proceedings consistent herewith.

APPENDIX B

UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

No. 93-7127

D.C. Docket No. J92-0077(W)(C)

IN THE MATTER OF:
AUSTIN DEVELOPMENT COMPANY,

Debtor.

EASTOVER BANK FOR SAVINGS,

Appellant,

versus

SOWASHEE VENTURE, ET AL.,

Appellees,

versus

AUSTIN DEVELOPMENT COMPANY and
J.C. Bell, Trustee,

Appellants.

Appeals from the United States District Court
for the
Southern District of Mississippi

Before HIGGINBOTHAM, DAVIS, and JONES, Circuit Judges.

JUDGMENT
(Filed May 3, 1994)

This cause came on to be heard on the record on appeal and was argued by counsel.

ON CONSIDERATION WHEREOF, It is now here ordered and adjudged by this Court that the judgments of the District and Bankruptcy Courts in this cause are reversed, and the cause is remanded to the District Court for further proceedings in accordance with the opinion of this Court.

IT IS FURTHER ORDERED that appellees pay to appellants the costs on appeal to be taxed by the Clerk of this Court.

A true copy
Test May 3, 1994
Clerk, U.S. Court of Appeals,
Fifth Circuit

By /s/ Marie Adams
Deputy

ISSUED AS MANDATE: MAY 25 1994

APPENDIX C

IN THE UNITED STATES DISTRICT COURT FOR THE SOUTHERN DISTRICT OF MISSISSIPPI JACKSON DIVISION

SOWASHEE VENTURE AND UNITED ARTIST THEATER CIRCUIT, INC.	PLAINTIFFS-APPELLEES
V.	CIVIL ACTION NO. J92-0077(W)(C)
AUSTIN DEVELOPMENT COMPANY AND EASTOVER BANK FOR SAVINGS	DEFENDANTS-APPELLANTS

ORDER AFFIRMING DECISION OF BANKRUPTCY COURT STATEMENT OF THE CASE

(Filed Feb. 10, 1993)

Invoking the court's appellate review of final orders hailing from the United States Bankruptcy Courts for the Southern District of Mississippi,[1] the appellants herein,

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[1] Title 11 U.S.C. Rule 8001(a) provides:

An appeal from a final judgment, order or decree of a bankruptcy judge to a district court or bankruptcy appellate panel shall be taken by filing notice of appeal with the clerk within the time allowed by Rule 8002. Failure of an appellant to take any step other than the timely filing of a notice of appeal does not affect the validity of the appeal, but is ground only for such action as the district court or the bankruptcy appellate panel deems appropriate, which may include dismissal of the appeal. The notice of appeal shall conform substantially to the appropriate Official Form, shall contain the names of all the parties to the judgment, order, or decree appealed from

Austin Development Company and Eastover Bank Savings, seek review of United States Bankruptcy Ju Edward Ellington's decision in this case on a numbe issues, especially of Judge Ellington's constructio Title 11 U.S.C. § 365 (d)(4)[2]. This section grants a de sixty (60) days to assume or to reject an unexpired l of nonresidential real property under which the debt the lessee; otherwise, the lease is deemed rejected and debtor is to surrender the property. The central i affecting § 365(d)(4) focuses upon the meaning "deemed rejected"; the appellees and the appellants strue the term differently. The Bankruptcy Judge, suaded by the argument of the appellees, Sowas Venture and United Artists Theater Circuit, Inc., de mined that the term means that the executory leas terminated. Appellants campaign here for a diffe interpretation: that the lease is not terminated, but me breached, and, thus, outside the administrative powe

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and the names, addresses and telephone numbers of their respective attorneys, and be accompanied by the prescribed fee. Each appellant shall file a sufficient number of copies of the notice of appeal to enable the clerk to comply promptly with Rule 8004.

[2] Title 11 U.S.C. § 365(d)(4) provides:

(4) Notwithstanding paragraphs (1) and (2), in a case under any chapter of this title, if the trustee does not assume or reject an unexpired lease of nonresidential real property under which the debtor is lessee within 60 days after the date of the order for relief, or within such additional time as the court, for cause, within such 60-day period, fixes, then such lease is deemed rejected, and the trustee shall immediately surrender such nonresidential real property to the lessor.

the bankruptcy court as the parties to the breach may resort to the state court to determine their respective rights. This court, as was the bankruptcy court, is not impressed with this construction of the term, but, contrariwise, is convinced that the term means that the lease is terminated. This court is also unpersuaded by appellant's other arguments against Judge Ellington's holding. Accordingly, this court affirms the bankruptcy court for the reasons which are set out below.

JURISDICTION AND PARTIES

This court's jurisdiction to review this matter is predicated upon Title 11 U.S.C. Rule 8001(a)[3] which provides for appeal from a final judgment, order or decree of a bankruptcy judge. The parties herein are Sowashee Venture (Sowashee), a Mississippi general partnership and the owner of certain nonresidential real property in Meridian, Mississippi on which a five-screen motion picture theater was built; United Artist Theater Circuit (United Artists), guarantor for R & S Theater, Inc. (R & S), the sublessee of Austin Development Company and operator of the motion picture theater; Austin Development Company (Austin or the debtor), the ground-lessee of the property who built the theater and sublet the premises to R & S; and Eastover Bank For Savings (Eastover Bank), a creditor of Austin, who holds a deed of trust on Austin's ground lease with Sowashee and who is also the assignee of the sublease from Austin to R & S.

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[3] See footnote 1.

FINDINGS OF BANKRUPTCY COURT

The bankruptcy court entered a bench opinion which adopted the following facts stipulated by the parties:

> (1) On January 2, 1991, Austin filed a petition for Chapter 11 proceeding with this court (the bankruptcy court).
>
> (2) On March 28, 1991, Sowashee and United Artists filed a motion for relief from the automatic stay.
>
> (3) On May 28, 1991, Sowashee and United Artists filed a complaint to avoid liens and interests and cancel liens, Adversary No. 910130,. . . . (Eastover) Bank filed its answer on July 17, 1991.
>
> (4) (The parties stipulate to the jurisdiction and venue of the bankruptcy court).

Stipulations 5 through 14 pertain to the chain of title of the non-residential real property in question. Stipulations 15 and 16 recite conveyances to Sowashee by warranty deed which made Sowashee the owner of the property in question and successor to a ground lease with Austin.

> (17) Sowashee is the current holder of and successor in title to the Ground Lease on non-residential real property with Austin. . . .
>
> (18) On December 30, 1986, Austin borrowed $850,000.00 from (Eastover) Bank and as security therefor executed the following documents:
>
> > (a) A deed of trust to E. Frank Goodman, as trustee for (Eastover) Bank, covering Austin's interest in the Ground Lease . . . ; and

(b) An assignment to (Eastover) Bank of Austin's sublessor's interest in the sublease to R & S,. . . .

(19) [In this stipulation the parties agree that as of August 28, 1991, the outstanding indebtedness including advances to Austin by Eastover Bank is $918,308.32, plus accrued interest in the amount of $43,033.44; the parties further agree that interest continues to accrue after August 28, 1991, at the rate of $264.17 per day.]

(20) On December 31, 1986, (Eastover) Bank's attorney wrote Sowashee and gave notice that (sic) (Eastover) Bank's deed of trust and assignment and stated:

"Please send all notices required by paragraph 21 of the ground lease to Eastover Bank for Savings."

(21) On January 6, 1987, (Eastover) Bank's attorney wrote R & S and (sic) notifying them of the assignment of the Sublease to the (Eastover) Bank and requesting that all future payments be made to (Eastover) Bank.

(22) From January, 1987, through March 1991, R & S paid (Eastover) Bank all of the monthly payments (approximately $11,085 per month) under the Sublease to (Eastover) Bank; and during such time (Eastover) Bank paid Sowashee all monthly payment (sic) ($1500 per month), plus common area costs, due under the Ground Lease.

(23) On or about April 1, 1991, when (Eastover) Bank received R & S's check for $11,085.79 for the April, 1991, rent, (Eastover) Bank issued its check to Sowashee for $1,574.00 for the April 1991 payments under the Ground

Lease. Thereafter, Sowashee notified R & S not to pay (Eastover) Bank, and as a result R & S stopped payment on its check to (Eastover) Bank. Bank was unable to collect the R & S check.

(24) On or about April 4, 1991, R & S filed an application for interpleader. . . . After pleadings by various parties, on April 5, 1991, the (bankruptcy) Court entered an order directing investment of the interpled funds,. . . .

(25) On July 23, 1991, this Court (the bankruptcy court) entered an interim agreed order concerning interpleader funds,. . . . The parties have and are complying with this order. Pursuant to the order R & S is payigg (sic) Sowashee directly the $1,500.00 of monthly rent due, plus common area maintenance of about $75.00 per month, under the ground lease- . . . and is paying the balance of its rent under the Sublease to the Clerk of this Court (the bankruptcy court) under the April 5, 1991 order,. . . .

(26) On August 19, 1991, this Court (bankruptcy court) entered an order directing Clerk to disburse a portion of the interpled funds to Sowashee. . . . Sowashee has been paid the $7,862.20 covered by this order.

(27) On February 19, 1991, Austin filed a motion to modify stay,. . . . On March 19, 1991, the Court (bankruptcy court) entered an Agreed Order Modifying Automatic Stay. . . . Austin has not filed any other motions relating to the Ground Lease or the Sublease.

(28) Sowashee has not given (Eastover) Bank any notice of any alleged breach by Austin of

> the Ground Lease or of any cancellation or termination of the Ground Lease. . . .

The bankruptcy court found that when Sowashee became the holder of and successor in title to the non-residential real property in question, subject to the aforesaid ground lease and sublease, Sowashee also became the successor in interest to a non-disturbance agreement with R & S. The non-disturbance agreement required Sowashee and R & S to continue a lessor-lessee relationship in the event Austin no longer performed its sublessor duties.

The bankruptcy court further found that when Austin filed its petition for relief under Chapter 11 of the Bankruptcy Code on January 2, 1991, the petition was filed together with a list containing the names and addresses of each of its creditors as required by Rule 1007(a)(1)[4] of the Bankruptcy Rules. Further, the bankruptcy court found that on January 4, 1991, notice of the first meeting of creditors pursuant to 11 U.S.C. § 341 (a) was sent to all parties in interest, including Eastover Bank.[5] The notice set the date of the first meeting for January 25, 1991, at 11:30 A.M. The minutes of the United

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[4] Rule 1007(a)(1), 11 U.S.C. provides:

(a) List of creditors and equity security holder

(1) voluntary case

In a voluntary case, the debtor shall file with the petition a list containing the name and address of each creditor unless the petition is accompanied by a schedule of liabilities.

[5] Title 11 U.S.C. § 341(a) provides:

Meetings of creditors and equity security holders

(a) Within a reasonable time after the order for relief in a case under this title, the United States trustee shall convene and preside at a meeting of creditors.

States Trustee filed with the bankruptcy court on January 28, 1991, reflect that Eastover Bank was represented at this meeting by Charles Guyse.

Noting that § 365(d)(4) of the Bankruptcy Code requires a trustee or debtor-in-possession to assume or reject unexpired leases of nonresidential property within sixty (60) days after the date of the order for relief, the bankruptcy court found that the 60-day period expired on March 4, 1991. The bankruptcy court's findings also show that during the period between January 2, 1991, and March 4, 1991, Austin made no attempt to assume or reject its unexpired leases with Sowashee or R & S. Moreover, Eastover Bank made no motion to compel Austin to do so.

On September 24, 1991, after having heard arguments pursuant to the motions of the various parties for relief in regard to this matter, the bankruptcy court found that Eastover Bank had notice of Austin's bankruptcy and was represented at the first meeting of creditors, but did nothing to protect its deed of trust and promissory note serving as security for Austin's loan. According to the bankruptcy court, if the debtor-in-possession, Austin, did not assume or reject its unexpired leases of nonresidential real property within 60 days after the date of the order for relief, or seek additional time to do so within such 60-day period, then the leases were deemed rejected in accordance with § 365(d)(4) of the Bankruptcy Code.

Furthermore, pursuant to the non-disturbance agreement between Sowashee and R & S, Sowashee became R & S's landlord in the event Austin no longer served in that capacity. All rental payments previously paid by R &

S to Eastover Bank, the same payments being paid into the registry of the bankruptcy court pursuant to the aforesaid interpleader order, were directed to be paid to the landlord, Sowashee.

Eastover Bank, said the bankruptcy court, could have protected itself from this result by filing a motion within the 60-day period. Its standing to do so, opined the court, is set forth under Bankruptcy Rules 6006, 9013 and 9014.[6]

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[6] Rule 6006, Title 11 U.S.C. provides:

(a) Proceeding to assume, reject, or assign

A proceeding to assume, reject or assign an executory contract or unexpired lease, other than as part of a plan, is governed by Rule 9014.

(b) Proceeding to require trustee to act

A proceeding by a party to an executory contract or unexpired lease in a chapter 9 municipality case, chapter 11 reorganization case, chapter 12 family farmer's debt adjustment case, or chapter 13 individual's debt adjustment case to require the trustee, debtor-in-possession, or debtor to determine whether to assume or reject the contract or lease is governed by Rule 9014.

(c) Hearing

When a motion is made pursuant to subdivision (a) or (b) of this rule, the court shall set a hearing on notice to the other party to the contract or lease, to other parties in interest as the court may direct, and, except in a chapter 9 municipality case, to the United States trustee.

Rule 9013, 11 U.S.C. provides:

A request for an order, except when an application is authorized by these rules, shall be by written motion, unless made during hearing. The motion shall state with particularity the grounds therefor, and shall set forth the relief or order sought. Every written motion other than one which may be considered ex parte

However, since Eastover Bank had taken no action to protect its security interest by filing a motion under Bankruptcy Rule 9014, the bankruptcy court found that Eastover Bank's interest terminated with Austin's leases, and that Eastover Bank now had no recourse for protection of its security interest.

The bankruptcy court rejected the argument that Sowashee's acceptance of rent from Eastover Bank after Austin's petition for relief was filed operated as a waiver of any other rights under the Bankruptcy Code, hence, the leases should be permitted to continue pursuant to the prepetition arrangement. Referring to the case of *In Re Giles Associates, LTD.*, 92 B.R. 695 (Bkrtcy. W.D. Tex. 1988), the bankruptcy court stated that acceptance of rent by the lessor does not operate as a waiver or estoppel,

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shall be served by the moving party on the trustee or debtor in possession and on those entities specified by these rules of, if service is not required or the entities to be served are not specified by these rules, the moving party shall serve the entities the court directs.

Rule 9014, 11 U.S.C. provides in pertinent part:

> In a contested matter in a case under the Code not otherwise governed by these rules, relief shall be requested by motion, and reasonable notice and opportunity for hearing shall be afforded the party against whom relief is sought. No response is required under this rule unless the court orders an answer to a motion. The motion shall be served in the manner provided for service of summons and complaint by Rule 7004, . . .

especially when the continued payment of rent by the trustee is required by § 365(d)(3).[7]

The bankruptcy court also rejected Eastover Bank's argument that paragraph 21 of the ground lease between Sowashee and Austin requires that Sowashee give Eastover 30 days' notice prior to any termination, notwithstanding the provisions of § 365(d)(4). According to Eastover's argument, the ground lease protects it from the consequences of Austin's default because (1) the ground lease permitted Austin to enter into a "leasehold mortgage", (2) Sowashee agreed not to modify or cancel the lease without Eastover's consent, and (3) if the lease terminated, then Eastover could lease the property from Sowashee pursuant to the same terms and conditions as had Austin. This, argued Eastover, would be the equitable thing to do since it would permit servicing of the Austin loan to continue. In response to Eastover's

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[7] Title 11 U.S.C. § 365(d)(3) provides:

> **(3)** The trustee shall timely perform all the obligations of the debtor, except those specified in section 365(b)(2), arising from and after the order for relief under any unexpired lease of nonresidential real property, until such lease is assumed or rejected, notwithstanding section 503(b)(1) of this title. The court may extend, for cause, the time for any performance of any such obligation that arises within 60 days after the date of the order for relief, but the time for performance shall not be extended beyond such 60-day period. This subsection shall not be deemed to affect the trustee's obligations under the provisions of subsection (b) or (f) of this section. Acceptance of any such performance does not constitute waiver or relinquishment of the lessor's rights under such lease or under this title.

"ground lease" argument, Sowashee noted that the ground lease had not been rejected due to any contractual breach by Austin. Instead, the ground lease had been deemed rejected and terminated as a matter of law under § 365(d)(4) because neither Austin nor Eastover had taken any action within 60 days to affirm or reject the lease. Therefore, any rights which arose pursuant to the Austin lease with Sowashee were extinguished.

Referring once again to the case of *In Re Giles Associates, LTD.*, the bankruptcy court agreed with Sowashee that the termination of the ground lease in the case *sub judice* occurred under the separate statutory mandate of § 365(d)(4) and that the terms of the ground lease could not be used to circumvent the requirements of the Bankruptcy Code. The bankruptcy court relied upon the language in *Giles* which states that a bank must act to protect itself and that a court does not have a "roving commission to do equity" when a bank has failed to so act. *In Re Giles Associates, LTD., supra,* at 697-98, *citing United States v. Sutton,* 786 F.2d 1305, 1308 (5th Cir. 1986).

The bankruptcy court's bench opinion also rejected Eastover Bank's request to find § 365(d)(4) unconstitutional. According to Eastover Bank, Sowashee's immediate possession of the ground lease with no provision being made for the continued service of Eastover's promissory note is a denial of due process. The bankruptcy court referred to the § 341 first meeting of creditors. Eastover Bank was notified of this proceeding and had a representative present. Next, the court referred to the February 19, 1991, motion of Austin to modify the automatic stay. Even a cursory inspection of this motion, said the court, should have placed Eastover on notice that

Austin had not moved to assume or reject its unexpired leases. Therefore, as stated by the bankruptcy court, "[i]t does no good to argue that it (Eastover Bank) was denied its constitutional rights when it did nothing to protect them."

THE PARTIES' ARGUMENTS ON APPEAL

The appellants, Eastover and Austin, contend that the failure of Austin to assume or reject its unexpired leases within the 60-day period as required by § 365(d)(4) was due to inadvertence of Austin's initial counsel who, according to the appellants, was inexperienced in these matters and unaware of the duty to act within 60 days. However, say appellants, even if the court finds that the leases in question are rejected, this does not necessarily mean that they have been terminated. To so hold, say the appellants, will result in a windfall to Sowashee because it will receive all the rent payments while Eastover Bank's promissory note will go unserviced. If, on the other hand, the court would hold that the leases are merely breached, and not terminated, by the debtor's failure to assume or reject them within the 60-day period, then the leases would simply be beyond the administrative power of the bankruptcy court and permit the parties to resolve their rights in state court. According to the appellants, everything would remain virtually as it was before the 60-day period expired; R & S would pay rent to Eastover Bank and Sowashee's rent would be paid from the proceeds of the R & S payments by Eastover Bank.

The appellants argue that their suggested disposition of the matter on appeal is the equitable thing to do,

especially since, in the appellants' view, Eastover Bank had no standing to file the protective motion referred to by the bankruptcy court. Citing Rule 6006(b) of the Bankruptcy Rules, the appellants argue that only a party to an executory contract or an unexpired lease may bring such a motion. Therefore, inasmuch as Eastover Bank was not a party to the leases, it argues that it had no standing to file a motion to protect its rights under the leases.

Appellants also raise the issues of paragraph 21 of the ground lease and the argument of waiver and estoppel based upon Sowashee's continued acceptance of rent.

Finally, the appellants argue that § 365(d)(4) of the Bankruptcy Code should be found unconstitutional because it has been applied in a manner which deprives Eastover Bank of its rights without due process.

The appellees respond that the bankruptcy court's legal analysis is well reasoned and should be adopted by this court.

The bankruptcy court, say the appellees, was correct to hold that the debtor-in-possession's failure to assume or reject its unexpired leases within 60 days of the order for relief operated as a termination of the leases. Eastover Bank, say the appellees, could have avoided this outcome by filing a motion to protect its rights, but failed to do so. Moreover, say appellees, Eastover Bank cannot be heard to complain that it had no standing to bring a protective motion because it is a party in interest with a right to be heard on the matter of its security interest. Appellees cite 11 U.S.C. § 1109(b) which provides:

> (b) A party in interest, including the debtor, the trustee, a creditors' committee, an equity

> security holders' committee, a creditor, and equity security holder, or any indenture trustee, may raise and may appear to be heard on any issue in a case under this chapter.

Clearly, say the appellees, Eastover Bank had standing to file a motion and proceed to protect its security interest. If it did not do so within the 60-day period provided by § 365(d)(4), then the leases are rejected and possession must be immediately passed to the lessor, in this case Sowashee. This failure to act, coupled with the requirement of immediate surrender of possession by the lessee, argue appellees, results in termination of Austin's interest. Since Eastover Bank's interest arises only through Austin, argue appellees, its interest also terminates. Eastover obtained no additional security, nor did it enter into any non-disturbance agreements with Sowashee or R & S which would have protected its interests.

Eastover's reliance upon paragraph 21 of the ground lease, argue the appellees, fails because the lease was terminated as a matter of law, not because of any breach of contract. Finally, say the appellees, acceptance of rent from R & S was required by Sowashee's non-disturbance agreement with R & S and cannot be viewed a waiver of any rights under the bankruptcy laws.

Therefore, say the appellees, there is no basis for this court to find that Eastover Bank's interest still exists. The appellees urge the court to affirm the bankruptcy court's ruling.

This court has studied the holdings of the bankruptcy court and is in agreement on all points. Hence, this court, too, rejects appellants, theories relative to waiver and

notice. Additionally, this court agrees with the appellees that Eastover Bank cannot be heard to complain that it lacked standing to protect its interests under § 365(d)(4) when it clearly failed to take advantage of its right under Title 11 U.S.C. § 1109 to bring a Rule 9014 motion to compel Austin to assume or reject its unexpired leases. Further, the court agrees with the bankruptcy court's view on § 365(d)(4). Since the dispute on the construction of § 365(d)(4) is critical to the outcome of this litigation and since the dispute is fresh in this federal district, the court below in more detail discusses this matter.

ANALYSIS OF THE BANKRUPTCY COURT'S RULING ON § 365(d)(4)

The bankruptcy court found that Eastover Bank's failure to act on its rights, coupled with the § 365(d)(4) requirement that Austin, the debtor-in-possession, immediately surrender the nonresidential real property in question to Sowashee, caused the ground lease between Austin and Sowashee and the sublease between Austin and R & S to terminate. The court arrived at its decision relying primarily on the cases of *Sea Harvest Corporation v. Riviera Land Company*, 868 F.2d 1077 (9th Cir. 1989); *In Re Giles Associates, LTD.*, 92 B.R. 695 (Bkrtcy. W.D. Tex. 1988); *Matter of Healthcare Management, Inc.*, 900 F.2d 827 (5th Cir. 1990); *In Re Chris-Kay Foods East, Inc.*, 118 B.R. 70 (Bkrtcy. E.D. Mich. 1990); and *In Re U.S. Fax, Inc.*, 114 B.R. 70 (Bkrtcy. E.D. Pa. 1990).

In *Sea Harvest* the Ninth Circuit found that a debtor-in-possession failed to submit a proper motion to assume or reject its unexpired leases within the 60-day period

provided by § 365(d)(4) and that this failure resulted in termination of the leases. The Court stated:

> Debtors suggest that even if the leases were properly "deemed rejected" under section 365(d)(4), this is not the same as termination of the lease. To hold otherwise, they argue, would deprive the bankruptcy court of its power under section 365(a) to approve the decision to assume or reject, in that a debtor in possession could passively reject a lease regardless of court approval.
>
> A cursory examination of section 365(a) reveals that this argument lacks merit. Section 365(a) applies, by its terms, "[e]xcept as provided . . . in subsection[] . . . (d) of this section," so any conflict between section 365(a) and section 365(d)(4) must be resolved in favor of the latter. Congress considered court approval of the decision to reject under section 365(a) less important than the presumption of rejection under section 365(d)(4) if the debtor in possession or trustee fails to act in 60 days.
>
> Moreover, after a lease is deemed rejected under section 364(d)(4), the trustee or debtor in possession must "immediately surrender" the leased property to the lessor. 11 U.S.C. § 365(d)(4). Surrender of property, whether its use is for a retail store in a mall or a clam harvesting operation in the tidelands, has the effect of terminating the enterprise that operates there. If Congress intended passive rejection of a lease to be subject to court approval, it would not have required the drastic step of immediate surrender.

Sea Harvest Corporation v. Riviera Land Company, at 1080-81.

The bankruptcy court was also persuaded by the case of *In Re Giles Associates, LTD., supra,* another decision adopting the view that the failure of a trustee or debtor-in-possession to assume or reject an unexpired lease of nonresidential real property within 60 days results in termination of the lease. The *Giles* Court embraced the rationale of *In Re Bernard,* 63 B.R. 12 (Bkrtcy. D. Hawaii 1986), which held that automatic rejection of a lease under § 365(d)(4) terminates a lease as to all parties, including creditors. By adopting the Bernard rationale, the *Giles* Court rejected the holding of *In Re Storage Technology Corporation,* 53 B.R. 471 (Bkrtcy. D. Colo. 1985), that automatic rejection of a lease under § 365(d)(4) did not work a termination of the leasehold. According to the *Giles* Court, the split in authority was easily resolved:

> The issues are really very simple and straightforward. Under § 365(d)(4), a lease of non-residential real property is deemed rejected sixty days after the date of a petition in bankruptcy (under Chapter 11 or any other chapter) unless the trustee or debtor-in-possession takes some action to preserve the lease, either by filing a motion to assume or by filing a motion to extend the time for assumption or rejection. *See generally, In Re Southwest Aircraft Services, Inc.,* 831 F.2d 848 (9th Cir. 1987). If no action is taken, the lease is deemed rejected, and the trustee or debtor in possession must surrender possession of the premises.

In Re Giles Associates, LTD., at 696.

The *Giles* Court rejected the argument that § 365(d)(4) was subject to state law doctrines concerning termination of leases. Moreover, the *Giles* Court found irrelevant the provision of the lease requiring notice of breach by the landowner to the debtor since the lease was not rejected due to any contractual breach, but by operation of law as set forth in the Bankruptcy Code. Also rejected was the argument that the landowner's acceptance of rent operated as an assumption of the lease. Referring to Title 11 U.S.C. § 365(b) and Rule 6006(a) of the Bankruptcy Rules requiring a motion pursuant to Rule 9014, the *Giles* Court noted that assumption of the lease cannot occur without some pleading being filed with the bankruptcy court.[8] The acceptance of monthly rent, said the Giles Court, is made mandatory by § 365(d)(3).[9] So, quoting the legislative history of 365(d)(4), 130 Cong.Rec.

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[8] Title 11 U.S.C. § 365(b)(l) provides:

(b)(1) If there has been a default in an executory contract or unexpired lease of the debtor, the trustee may not assume such contract or lease unless, at the time of assumption of such contract or lease, the trustee –

(A) cures, or provides adequate assurance that the trustee will promptly cure, such default;

(B) compensates, or provides adequate assurance that the trustee will promptly compensate, a party other than the debtor to such contract or lease, for any actual pecuniary loss to such party resulting from such default; and

(C) provides adequate assurance of future performance under such contact or lease.

[9] Title 11 U.S.C. § 365(d)(3) provides in pertinent part:

(3) The trustee shall timely perform all obligations of the debtor, except those specified in section 365(b)(2), arising from and after the order for relief under any unexpired lease of nonresidential real property, until such lease is assumed or rejected, notwithstanding section 503(b)(1) of this title.

S8894-95 (Daily Ed. June 29, 1984), the Court noted that, "[t]he acceptance by the lessor of any payments made by the trustee as required by . . . [365(d)(3)] does not constitute a waiver or relinquishment of the lessor's rights under such lease or under the bankruptcy code."

The *Giles* Court concluded its analysis by rejecting the argument that failure to assume or reject an unexpired lease constitutes merely a breach of the lease, not termination:

> . . . Failure to act results in first rejection and next in an absolute obligation to surrender the premises: "If the trustee does not assume or reject an unexpired lease . . . , then such lease is deemed rejected and the trustee shall immediately surrender such nonresidential real property to the lessor." § 365(d)(4).
>
> To say, . . . , that the failure to act is merely a "breach" is not consistent with either the statute or its history. Why not? Because § 365(d)(4) deems that the trustee or debtor has, by failing to act, breached the lease and that the breach is so serious that immediate surrender is mandatory. The breach plus surrender obligation can only be seen as termination of any of the trustee's or debtor's rights in the leasehold. Otherwise, the face of the statute and its history are meaningless.
>
> Further, . . . , reliance upon the use of different terms – "rejection", "breach", and "termination" – at different sections of the Code is not proper. Yes, Congress should have used consistent terms, but Congressional inconsistency creates no presumptions.
>
> For example, "breach" is equated with "rejection" at 365(g) so as to make post-petition

> rejection give rise to a pre-petition (non-priority) claim. This section – § 365(g) – does not, therefore, merely define "rejection" or "breach", . . . [10]
>
> Analysis of the Code, then, clearly shows that § 365(d)(4) terminates leases. The poor creditor in the position of the bank, done in by this provision, is in no worse position than a second lienholder faced with a § 362 motion for relief where the debtor cannot provide adequate protection. The bank must act to protect itself. This court does not have a "roving commission to do equity." *See United States v. Sutton*, 786 F.2d 1305, 1308 (5th Cir. 1986).

In Re Giles Associates, LTD., at 697-98.

The bankruptcy court was also persuaded by the case of *American Healthcare Management, Inc.*, 900 F.2d 827 (5th Cir. 1990), holding that a bankruptcy court may grant multiple extensions of the 60-day time period provided by § 365(d)(4) for a lessee of non-residential real property to assume or reject an unexpired lease, so long as the request is made for good cause and prior to the expiration of the previously granted extension.

Finally, the bankruptcy court cited *In Re Chris-Kay Foods East, Inc.*, 118 B.R. 70 (Bkrtcy. E.D. Mich. 1990), and *In Re U.S. Fax. Inc.*, 114 B.R. 70 (Bkrtcy. E.D. Pa. 1990). Both cases hold in accordance with § 365(d)(4) that a

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[10] 11 U.S.C. § 502(g) of the Bankruptcy Code provides that a claim arising from the rejection, under section 365 of this title, . . . , of an executory contract or unexpired lease of the debtor that has not been assumed shall be determined, . . . , as if such claim had arisen before the date of the filing of the petition.

lessor of nonresidential real property is entitled to immediate possession after the 60-day period for assumption or rejection by the trustee or debtor-in-possession expires and no action has been taken. *In Re Chris-Kay Foods East, Inc.*, adopts the rationale of *In Re Giles Associates, LTD., supra,* finding that the failure of the trustee or debtor-in-possession to assume or reject an unexpired lease within the 60-day period terminates the lease. *In Re U.S. Fax, Inc.*, holds that surrender of possession must be immediate under § 365(d)(4) and that this in no way conflicts with the automatic stay provisions of the Bankruptcy Code. Furthermore, the *In Re U.S. Fax, Inc.*, Court held that there is no requirement for a lessor who has taken immediate possession of the nonresidential real property to proceed to state court to have the lessor-landowner's right to possession adjudicated.

The court finds the bankruptcy court's ruling to be well reasoned and hereby affirms same. In arriving at the decision to affirm, the court has considered the various authorities submitted by the appellants and finds them unpersuasive. *See* Michael T. Andrew, *Executory Contracts in Bankruptcy: Understanding "Rejection"*, 59 U. of Colorado Law Review 845 (1988), and William E. Winfield, *Rejection of Non-Residential Leases of Real Property and Bankruptcy: What Happens to the Mortgagee's Security Interest?*, 17 Pepperdine Law Review 429 (1990); *Matter of Garfinkle,* 577 F.2d 901 (5th Cir. 1978), *Leasing Service Corporation v. First Tennessee Bank National Association,* 826 F.2d 434 (6th Cir. 1987), and *Matter of Greystone III Joint Venture,* 948 F.2d 134 (5th Cir. 1991).

Matter of Garfinkle, supra, is a Fifth Circuit decision under section 70(b) of the old Bankruptcy Code. The

factual circumstances differ from the case *sub judice* in that the debtor, Barbara Garfinkle, was the fee title holder of the nonresidential real property in question, the Eden Roc Hotel. When Garfinkle purchased the hotel, it was already subject to a mortgage in favor of Aetna Life Insurance Company. Additionally, when Garfinkle purchased the property, she bought the fee interest from one Sam Cohen and the leasehold interest of one Morris Lansburgh who held a 999-year lease on the hotel.[11] Garfinkle executed mortgages encumbering the fee interest in favor of Cohen and the leasehold interest in favor of Lansburgh. The parties agreed that title would not merge until Cohen's mortgage on the fee was satisfied. Garfinkle then executed a land trust arrangement with Miami Beach National Bank with herself as beneficiary and the bank as trustee.

When Garfinkle initiated Chapter XII Bankruptcy proceedings, she was both the lessor and the lessee of the hotel. The trustee, acting for Garfinkle in her capacity as lessor of the hotel, sought to assume the 999-year lease, then reject it pursuant to a clause in the lease instrument permitting the lessor to terminate the lease anytime the lessee was adjudged bankrupt or insolvent. The trustee additionally sought to reject the lease for Garfinkle as lessee of the hotel. Lansburgh objected to both the lessor's exercise of the default clause and the lessee's rejection of the lease, arguing that such termination or

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[11] This made Garfinkle both lessor and lessee of the hotel. By analogy to the case *sub judice, Garfinkle as lessor was in the position of Sowashee, while as lessee Garfinkle's position was like that of Austin.*

rejection of the 999-year lease would render his mortgage useless.

The bankruptcy court held that the trustee's rejection on behalf of Garfinkle as lessee (the position of Austin in the case *sub judice*), did not terminate the 999-year lease but merely removed it from bankruptcy administration.[12] Although the Fifth Circuit reversed and remanded the bankruptcy court's decision in this case, the Fifth Circuit agreed that the trustee's rejection of the 999-year lease on behalf of Garfinkle as lessee did not destroy the leasehold estate and render Lansburgh's mortgage useless. Therefore, Lansburgh would be free to pursue his mortgage against Garfinkle, as lessee, outside the administration of the bankruptcy court. In the case *sub judice*, no one argues that Eastover Bank has no recourse against Austin.

However, when considering the matter of the trustee's rejection of the 999-year lease on behalf of Garfinkle as lessor, (Sowashee's position in the case *sub judice*), the Fifth Circuit remanded the case for further consideration of how the leasehold mortgage interest (the same interest held by Eastover Bank in the case *sub judice*) survived the trustee's rejection. Footnote 8 of the *Garfinkle* decision says that, unless the mortgagee is otherwise protected, a mortgagee of a leasehold interest loses

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[12] Furthermore, said the bankruptcy court, the side agreement preventing merger of title until Cohen's mortgage was satisfied would not permit Garfinkle as lessor to reject the lease since title would be merged contrary to the covenant against merger. Finally, the bankruptcy court found that the trustee could not equitably exercise the default clause because Garfinkle, as both the lessor and the lessee, could not create claims against herself.

if a trustee makes an affirmative decision to terminate a lease. According to Lansburgh, his protection from loss of his leasehold mortgagee's interest existed in the form of a lease modification which gave Lansburgh the opportunity to cure the lessee's default.[13] The case was remanded for consideration of whether the leasehold mortgagee's interest could survive the trustee's rejection pursuant to a "pick-up" lease arrangement.

The Fifth Circuit in *Garfinkle* dealt with the effect of a trustee's actual rejection of a lease. There was no failure to assume or reject the unexpired 999-year lease by the debtor. Moreover, the leasehold mortgagee objected to the actions taken by the trustee and sought to protect his mortgage. In the case *sub judice*, the court is not concerned with what protections Eastover Bank may or may not have because it lost its power to protect its interest by operation of law when it failed to move to compel Austin to declare its intentions within the 60-day period provided by § 365(d)(4). The court finds nothing in the *Garfinkle* decision which runs counter to Judge Ellington's decision.

The case of *Leasing Service Corporation v. First Tennessee Bank National Association*, 826 F.2d 434 (6th Cir. 1987), is cited by the appellants because of the Sixth Circuit's statement that a trustee's rejection of a lease has the effect of breaching a lease agreement. However, whether a trustee's rejection of a lease operated as a termination of the lease or merely a breach of the lease was not the issue in this case. Instead, the Court was asked to determine

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[13] The lease modification is referred to as a "pick-up" lease.

whether the trustee's rejection of a lease operated to extinguish a security interest.

The facts of the case are relatively simple. Leasing Services Corporation (LSC) was assigned the lease interest in two pieces of material handling equipment (cranes). The amounts due under the leases were secured by a security interest in all the lessee-debtors's equipment and inventory. LSC perfected the security interest by filing a UCC-1 financing statement. Later, First Tennessee National Bank (Bank) loaned the lessee-debtor money and perfected its security interest in the same collateral. When the lessee-debtor was placed in involuntary bankruptcy under Chapter 7 of the Bankruptcy Code, the Bank sold all of the collateral, including the cranes. LSC reclaimed the cranes and sold them, creating a deficiency of $81,492.88. LSC then sued Bank for the deficiency. Bank argued that the trustee's rejection of the crane leases operated to reject all covenants contained therein, including the grant of a security interest in the lessor. LSC responded that while the trustee's rejection had the effect of a breach of the lease contract, it had no effect on LSC's secured status. The Sixth Circuit agreed, holding that § 365 of the Bankruptcy Code permits a trustee to reject executory obligations, not non-executory agreements such as security interests.

Therefore, the leasehold mortgagee's interest in *Leasing Service Corporation v. First Tennessee Bank National Association* was protected by the security interest contained in the lease, not by an adjudication that a trustee's failure to assume or reject a lease under § 365 operated as a termination or merely as a breach of contract. The court

finds nothing in this case with which to refute Judge Ellington's decision.

The case of *Matter of Greystone III Joint Venture*, 948 F.2d 134 (5th Cir. 1991), involved a lessor-debtor's attempt to win acceptance of a plan of reorganization under Chapter 11 of the Bankruptcy Code. The case finds that an unexpired lease neither assumed or rejected by a lessor-debtor remains in effect with regard to the lessees and the lessees have no claim against the lessor-debtor's bankruptcy estate. Therefore, the issue in *Greystone* was whether lessees constituted a class of creditors required to vote on the lessor-debtor's Chapter 11 plan, not whether a trustee's failure to assume or reject an unexpired lease constituted termination or mere breach of the lease. The court finds nothing in *Greystone* with which to contradict Judge Ellington's findings.

The law review articles relied upon by the appellants present the authors' slanted arguments regarding how the term "rejection" should be interpreted. The court finds them unpersuasive.

In Re Car-Gill, Inc., 125 B.R. 133 (Bkrtcy. E.D. Pa. 1991), and *In Re Austin*, 102 B.R. 897 (Bkrtcy. S.D. Ga. 1989), are cited by the appellants in support of their argument that continued payment and acceptance of rent should operate as an acceptance of the unexpired lease and estop subsequent attempts to reject a lease. The court has reviewed these cases and finds that both involve continued rental payments by a lessee-debtor to a landlord for a period of time well beyond the 60-day period provided by § 365(d)(4). Later, when the lessee-debtor's financial position collapsed, the landlord attempted to

"deem" the lease rejected by the lessee's trustee and put the lease outside the administrative power of the bankruptcy court. In *Car-Gill* the bankruptcy court found that the landlord had not only continued to accept rent well past the 60-day period, but also obtained a significant financial commitment from the lessee-debtor toward renovation and improvement of premises.

In *Austin* the bankruptcy court found that a landlord's continued acceptance of rent payments from the debtor-lessee and failure to take action to repossess after expiration of the 60-day period estopped the landlord from subsequently claiming that the lease should be viewed as rejected pursuant to 365(d)(4). Neither *Car-Gill* nor *Austin* involve the claims of a leasehold mortgagee such as Eastover Bank. Instead, the dispute is directly between the landlord and the lessee-debtor. These cases do not offer conclusions contrary to the findings of Judge Ellington in the case *sub judice.*

Finally, the court has reviewed other cases cited by the appellants such as *In Re Modern Textile, Inc.*, 900 F.2d 1184 (8th Cir. 1990) (lessor may still look to lessee's guarantor when lessee's trustee rejects the lease); *In Re Murphy,* 694 F.2d 172 (8th Cir. 1982) (debtor's rejection of land sale agreement gives purchaser cause of action against estate; pleadings regarding dispute held sufficient to constitute notice of purchaser's claim); and *Larkins v. Sills,* 377 F.2d 1 (5th Cir. 1967) (cooperation between landlord and lessee-debtor operated as waiver of landlord's right to terminate lease). None of these cases offers grounds for rejection of Judge Ellington's findings.

Therefore, the ruling of the bankruptcy court is hereby affirmed. A separate judgment shall be entered pursuant to Rule 58 of the Federal Rules of Civil Procedure in accordance with this order.

SO ORDERED AND ADJUDGED, this the 10th day of February , 1993.

/s/ Henry T. Wingate
UNITED STATES
DISTRICT JUDGE

Civil Action No. J92-0077(W)(C)
Order Affirming Decision of Bankruptcy Court

APPENDIX D

IN THE UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF MISSISSIPPI
JACKSON DIVISION

SOWASHEE VENTURE AND
UNITED ARTIST THEATER
CIRCUIT, INC. PLAINTIFFS-APPELLEES

V. CIVIL ACTION NO. J92-0077(W)(C)

AUSTIN DEVELOPMENT COMPANY
AND EASTOVER BANK FOR
SAVINGS DEFENDANTS-APPELLANTS

JUDGMENT

(Filed Feb. 10, 1993)

This matter is before the court pursuant to an appeal from the United States Bankruptcy Court, and this court, having affirmed the decision of the Bankruptcy Judge in accordance with the court's Order Affirming Decision of Bankruptcy Court dated February 10, 1993, hereby directs that the above-styled and numbered cause be fully and finally dismissed.

SO ORDERED AND ADJUDGED, this the 10th day of February , 1993.

/s/ Henry T. Wingate
UNITED STATES
DISTRICT JUDGE

APPENDIX E

UNITED STATES BANKRUPTCY COURT
SOUTHERN DISTRICT OF MISSISSIPPI
JACKSON DIVISION

AUSTIN DEVELOPMENT COMPANY, A MISSISSIPPI CORPORATION

R & S THEATERS, INC.

VS.

AUSTIN DEVELOPMENT COMPANY, UNITED ARTISTS THEATER CIRCUIT, INC., AGENTS FINANCING, INC. AND EASTOVER BANK FOR SAVINGS, N.A.

UNITED ARTISTS THEATER CIRCUIT, INC.

VS.

AUSTIN DEVELOPMENT COMPANY AND EASTOVER BANK FOR SAVINGS

No. 9100017MC

BENCH RULING
HONORABLE EDWARD ELLINGTON

Tuesday, September 24, 1991
1:30 p.m.

APPEARANCES:

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REPORTED BY:

LACY DURHAM
Court Reporter
Notary Public

[p. 3] THE COURT:

The Court has before it today Motion No. 910395 in the case of Austin Development Company, Bankruptcy No. 9100018. This is a Motion for Relief from the Automatic Stay and for certain other relief filed by certain of the creditors or parties in interest. There is also a Motion to Dismiss the case filed by the debtor and certain objections thereto. Additionally, there are two related adversary proceedings, being Adversary Proceedings No. 910073 and 910130.

These matters were heard on August 28, 1991, and they are reset for today for the rendering of an oral opinion by this Court.

The following comments constitute findings of facts and conclusions of law as required by Bankruptcy Rules 7052 and 9014. I will not go through all of the pleadings, but they are all interrelated and overlapping.

Briefly stated, the issue is what effect, if any, does the filing of bankruptcy by the debtor have on certain leases and security agreements relating to a movie theater in Meridian, Mississippi.

The parties have entered into a very [p. 4] detailed stipulation of the facts, and the Court adopts and incorporates the stipulation into this opinion by reference. On pages 3 and 4 of the brief of Eastover, there are certain charts which illustrate the various conveyances, leases and assignments which are contained in the stipulation. Those charts are also made part of this opinion. If there is a conflict between the stipulation and the charts, the stipulation prevails over the charts.

In addition to the stipulation, the Court takes judicial notice of its own files. At the hearing on August 28, there was a limited amount of testimony and admission of certain other exhibits.

In reaching a conclusion, it will be helpful to summarize some of the facts contained in the stipulation and record and to state the issues involved in more detail.

On January the 2nd, 1991, the debtor, Austin Development Company, filed a petition pursuant to Chapter 11 of the Bankruptcy Code. It has remained as a debtor-in-

possession. At the time of filing, Austin held a ground lease from Sowashee Venture, Inc., on a movie theater, which [p. 5] is nonresidential real property. Austin had subleased it to R&S Theaters, Inc., who actually operated the theater. In November 1983, when R&S subleased the property, they also obtained separate, written non-disturbance agreements from the actual land owner and from the predecessor of Sowashee that would protect R&S in the event the ground lease to Austin was terminated.

The debtor borrowed money from Eastover Bank, and, to secure the loan, the debtor had given a deed of trust to the bank on the ground lease from Sowashee and had also assigned to the bank the sublease with R&S.

R&S would pay directly to the bank the rent due on the sublease from Austin, and the bank would pay to Sowashee the rent which Austin owed on the ground lease.

There have been numerous conveyances, loans, and assignments over the years as contained in the stipulation, but the essential parties and the situation as it existed at the time of filing and currently is as shown on the chart on page 4 of the brief of Eastover.

The primary questions before the Court are whether the ground lease between Austin and [p. 6] Sowashee has been rejected; and, if it has, what is the effect of the rejection.

The resolution of the issues is controlled by Section 365(d) of the Code and Bankruptcy Rules 6006, 9014 and 9013.

Section 365(d)(4) is as follows : (Reading) Notwithstanding paragraphs (1) and (2), in a case under any chapter of this title, if the trustee does not assume or reject an unexpired lease of nonresidential real property under which the debtor is the lessee within 60 days after the date of the order for relief, or within such additional time as the Court, for cause, within such 60-day period, fixes, then such lease is deemed rejected, and the trustee shall immediately surrender such nonresidential real property to the lessor.

Bankruptcy Rule 6006 provides that a proceeding to assume, reject or assign an unexpired lease or to require the trustee, debtor-in-possession or debtor to determine whether to assume or reject a lease is governed by Bankruptcy Rule 9014. Bankruptcy Rule 9014 then provides that relief shall be requested by motion with notice and opportunity for hearing afforded [p. 7] to the opposing party. Bankruptcy Rule 9013 specifies the standards as to form and service to which a proper motion must conform.

In the case at bar, the petition was filed on January 2nd, 1991. Sixty days from that date was Sunday, March 3, 1991. Since the 60th day fell on a Sunday, the initial 60-day period provided by Section 365(d)(4) was extended to the next day, March, 4, 1991.

During the initial time period, there was no motion filed by the debtor-in-possession, Austin, to assume or reject the ground lease with Sowashee; no one filed a motion to compel the debtor-in-possession to determine whether to assume or reject the lease; and no one filed a motion to extend the 60-day time period.

Sowashee now argues that by operation of Section(d)(4) the ground lease is deemed rejected and, in effect, has been terminated; that it is entitled to immediate possession of the property and to have Eastover's lien removed from the property; and, that it is entitled to rental payments which R&S has been making into the registry of this Court.

Eastover argues to the contrary.

[p. 8] On February 9, 1991, Austin filed a Motion to Lift Stay in this court to allow litigation involving claims by and against Austin for rent on the general lease and sublease to proceed in state court. Eastover argues that this action was sufficient to show the debtor's intent to assume the lease and satisfied the requirements of Section 365(d)(4).

It further argues that if the debtor did not take the necessary action to assume the lease and it is deemed rejected, nevertheless, the lease is not terminated and the bank's deed of trust and assignment should continue in full force and effect.

Finally, it argues that Section 365(d)(4) is unconstitutional insofar as it proposes to affect the bank's property rights in the deed of trust and assignment because the Code section, on its face, does not grant the Bank standing as an interested party.

The Court has read the stipulation and the transcript of the hearing, including oral argument, together with the exhibits. It has also read and reread the briefs and cases cited therein. Additionally, it has researched and read

[p. 9] additional cases not contained in the briefs. It has also reviewed parts of the court file of this case.

The Court concludes that the debtor failed to take any action to assume the ground lease with Sowashee that would satisfy the requirements of Section 365(d)(4) and Bankruptcy Rules 6006, 9014 and 9013. The ground lease is deemed rejected by the operation of law and has been terminated. The Debtor and any entity claiming through it, such as Eastover, is required to immediately surrender the property to Sowashee and any related liens should be cancelled of record, unless its rights to possession are protected by agreements separate and apart from the rejected ground lease with Sowashee, such as the non-disturbance agreements held by R&S.

In addition, the Court concludes that for the period of time prior to March 5, 1991, Sowashee is entitled to only the ground lease payments of $1,500, plus common area costs which became due prior to March 5, and Eastover is entitled to the balance of the monthly payments which became due from R&S prior to March 5. From and after March 5, 1991, Sowashee is entitled to [p. 10] all monthly payments which became due from R&S.

The Court also concludes that the Motion to Dismiss should be held in abeyance until this matter becomes final, subject to further order of the Court.

The particular part of Section 365 involved in this case was added to the Bankruptcy Code by the Bankruptcy Amendment and Federal Judgeship Act of 1984. It quickly became apparent to the Court that although the provision is relatively new, the reported cases on the

various issues are numerous. Except for the issue Eastover raises as to the constitutionality of the statute, there are certainly cases on both sides of the major issues raised in this case.

However, the Court is of the opinion that certain cases in particular express what this Court believes to be the majority view and the better-reasoned approach. Three of these cases are: *Sea Harvest Corp. v. Riviera Land Co.*, 868 F.2d 1077 (9th Cir. 1989); *In Re Giles Associates, Ltd.*, 92 B.R. 695 (Bkrtcy. W.D.Tex. 1988); and the Fifth Circuit case of *Matter of American Healthcare Management, Inc.*, 900 F. 2d 827 (5th Cir. 1990).

[p. 11] In the *Sea Harvest* case, the debtors were involved in the managed harvesting and sale of clams. On August 27, 1986, the debtors filed a petition for Chapter 11 bankruptcy and commenced the 60 day period set forth in Section 365(d)(4). This period expired on October 26, 1986, a Sunday, but pursuant to Bankruptcy Rule 9006(a), the debtors had until the following Monday, October 27, 1986, to assume the lease. On October 27, 1986, the debtors filed documents entitled "Affirmation and Assumption of Executory Contracts" which listed leases of tidelands, including one from Riviera and one from another land owner. Riviera moved the Bankruptcy Court for an order declaring that the leases had been rejected. The Bankruptcy Court ruled that the leases had been rejected, and this was affirmed by the District Court. Judge Wallace, writing for the Ninth Circuit, affirmed on appeal.

In his opinion, Judge Wallace noted that before 1984, debtors-in-possession under Chapter 11 had no fixed

deadline for assuming or rejecting unexpired nonresidential leases. The 1984 amendments require the debtor-in-possession to perform all lease obligations while deciding [p. 12] whether to assume or to reject and established a 60-day deadline for assuming or rejecting, although a debtor could petition the Court for extension of time.

He went on to say, if a debtor fails to act before the deadline, the lease is deemed rejected and the debtor must immediately surrender the leased property to the lessor. The debtor's decision to assume is not a unilateral decision, but rather is subject to the Court's approval. He further noted that the purpose of the legislation was to protect lessors from delay and uncertainty by forcing a trustee or debtor-in-possession to decide quickly whether to assume unexpired leases and to protect the bankruptcy estate from unexpected liability by providing a statutory presumption of rejection unless the trustee or debtor-in-possession acts affirmatively to bring an unexpired lease into the estate.

He went on to say that Rule 6006(a) provides that a proceeding pursuant to Section 365(d)(4) is governed by Bankruptcy Rule 9014 which states that relief shall be requested by motion with reasonable notice and opportunity for hearing afforded to opposing party. He then [p. 13] stated that Bankruptcy Rule 9014 provides that a motion must "state with particularity the grounds therefor, and set forth the relief or order sought." I believe that should be Bankruptcy Rule 9013.

In addition to other faults he found with the documents that had been filed by the debtors with the Court on October 27, 1986, he stated that the documents did not

state any grounds for the assumption, let alone state grounds with particularity. He then held that the debtors had failed to file a proper motion within the 60-day period and the leases were deemed rejected.

The Court is of the opinion that any knowledgeable person making a disinterested examination of the motion to lift stay filed by Austin on February 9, 1991, could only conclude that it was not a motion to assume a lease as anticipated by Section 365(d)(4) and related rules.

Judge Wallace then turned to the debtor's argument that even if the leases were properly "deemed rejected", that rejection was not the same as termination of the lease. He did not [p. 14] accept this argument. He based his decision in part on the wording contained in the last sentence of Section 365(d)(4). He noted that the language mandates that the trustee or debtor-in-possession must "immediately surrender" the leased property to the lessor. He reasoned that surrender of the property has the effect of terminating the enterprise that operates there, and he stated that if Congress had intended for passive rejection of a lease to be subject to Court approval, it would not have required the drastic step of immediate surrender.

This Court will now review the previously cited *Giles* case. *Giles* was decided on August 8, 1988, by Bankruptcy Judge Glen Ayers, Jr. in the Western District of Texas. The facts and issues raised in that case are very similar to the ones in the case at bar.

The debtor, Giles Associates, filed a petition pursuant to Chapter 11 on January 4, 1988. It operated a commercial building. It owned ½ of the building, and leased the

other half of the building from the City of San Antonio. The National Bank of Commerce had a first deed of trust on the 1/2 of the building owned by the [p. 15] debtor and the debtor had also given the Bank a lien on its leasehold interest as additional collateral.

After the filing of the petition, the bank tendered several rental payments to the city, which were duly accepted. However, neither the debtor nor the bank took any action to assume the lease between the debtor and the city within the 60-day period set forth in Section 365(d)(4).

After the expiration of the 60-day period, the city filed a motion seeking to have the lease deemed rejected. In its response, the bank alleged that even if the lease between the debtor and city was "deemed rejected" that Section 365(d)(4) did not work as a termination of the leasehold. It based its argument on the case of *In Re Storage Technology Corp.*, 53 B.R. 471 (Bkrtcy.D. Col. 1985) which is cited by Eastover in its brief in the case at bar. In *Giles*, Judge Ayers made a very detailed analysis of the opinion in *Storage Technology* with particular emphasis on the legislative history that prompted the enactment of the amendment. I will not attempt to go through his analysis in detail, but this Court accepts it as a correct statement of the law. In simple terms, he states that unless the appropriate motion is filed within 60 days or an extension is obtained, then the lease is deemed rejected and the debtor must surrender possession of the premises. These provisions of Section 365 are not affected by separate state law doctrines concerning the termination of leases because state law does not control this issue. The federal policy concerning leases and the results from inaction on

the part of the debtor clearly supersede any state law considerations.

Judge Ayers went on to hold that the fact that the lease required some notice of breach to be provided by the city to the lessor was irrelevant because the lease had not been rejected due to any contractual breach by the lessee. The lease was deemed rejected as a matter of law as set forth in the Bankruptcy Code. He also held that there was no validity in the argument by the bank that the city had somehow accepted an assumption or other treatment of the lease by accepting the rent payments from the lienholder. He OPINED that lease assumption is something more than the acceptance of rental payments; that assumption of a lease cannot occur without some [p. 17] pleading being filed with the Court; and that Section 365(d)(3) makes mandatory the payment of all sums due under a lease from the debtor-lessee to a lessor, irrespective of whether or not assumption or rejection occurs. This requirement of the payment of rent is very clear, and it has nothing to do with the issue of assumption or rejection.

Judge Ayers further opined that although the lease may have provided options which would allow the debtor or some third party lienholder to cure defaults under the lease, that as between the city and the debtor no default had occurred under the lease. The lease was terminated under a separate statutory mandate not linked in any way whatsoever to the terms of the lease.

Without going into all of the facts and particular holdings of the Courts, this Court would cite two additional cases which hold that if a proper motion is not filed

timely, a nonresidential lease is deemed rejected; that the lessor is entitled to immediate possession after the rejection; and, that the lessor is not compelled to pursue state law remedies.

[p. 18] The first case is *In re U.S. FAX, INC.* decided by a District Court in the Eastern District of Pennsylvania on April 25, 1990. I'll need to get the citations on that. This case contains an extensive review of the legislative history of the amendment and the problems which it was intended to cure.

The second case is *In re CHRIS-KAY FOODS EAST, INC.*, decided in the Bankruptcy Court for the Eastern District of Michigan on August 23, 1990. And I'll also furnish that citation in a moment. This case is cited because it contains on page 72 a very extensive list of cases on both sides of the issue.

The judge in that case also states his agreement with Bankruptcy Judge Ayers' explanation in the *Giles* case as to why rejection of a lease terminates the lease and states that Judge Ayers' response to the *Storage Technology* case is well reasoned and reflects the overwhelming weight of authority.

The previously cited Fifth Circuit case of *Matter of American Healthcare Management, Inc.* which was decided May 11, 1990, also influenced the thinking of this Court. The Fifth [p. 19] Circuit was required to interpret Section 365(d)(4). The issues in that case are not the exact same issues that have been raised in this case. In that case, the Fifth Circuit held that a Bankruptcy Court may grant multiple extensions of time in which a lessee must assume or reject leases of nonresidential real property so

long as (1) a motion to extend is brought prior to the expiration of the period as previously extended, and (2) there is "cause" for granting the extension. The Court also held that when the initial 60-day period or any extension thereof ends on a Saturday, a Sunday, or a legal holiday, then Rule 9006(a) applies and the deadline is extended to the next workday; and, that as long as a debtor files a motion for extension of time within the initial 60 days or any authorized extensions, that the Court may grant such motions without notice to the other side pursuant to Rule 9006(b)(1).

Although the issues were not the exact same as the ones in this case, from reading the case it is clear to this Court that in regard to Section 365(d)(4) the Fifth Circuit was clearly cognizant, to borrow a phrase from an old song [p. 20] "what a difference a day makes, just 24 little hours." In the case at bar, it was much more than 24 hours.

The Court will now comment on the argument of Eastover that Section 365(d)(4) is unconstitutional. At the risk of this Court shirking its duty, it simply is not going to undertake to rule whether or not the statute is unconstitutional. This Court is of the opinion that it would be presumptive for an Article I Judge to rule an act of Congress to be unconstitutional. That is a matter that should more properly be ruled on by Article III Court.

However, this Court will make certain findings and conclusions in regard to this issue. On January 2, 1991, the debtor filed its petition for relief, together with a list containing the name and address of each creditor as

required by Bankruptcy Rule 1007(a)(1). The list of creditors was in the proper form to be used as the mailing matrix which is then used to give required notices to all parties in interest. The third name and address in the left hand column of the list of creditors was the Eastover Bank for Savings. On January 4, 1991, notice of the first meeting of [p. 21] creditors pursuant to S341(a) was sent to all parties in interest, including Eastover. The notice set the date of the first meeting on January 25, 1991, at 11:30 A.M. in the Federal Building in Meridian, Mississippi. The meeting was held on January 25, 1991, as noticed and the proceeding memo and minutes of the S341 meeting were filed by the U.S. Trustee in the court files on January 28, 1991. Those minutes reflect that Eastover Bank for Savings was represented at that meeting by Mr. Charles Guyse and his signature is on the S341 appearance sheet. It is clear that Eastover Bank for Savings was placed on notice of the bankruptcy clearly in the case and had a representative attend the first meeting of creditors. This was all well within the initial 60-day period. During the initial 60-day period and for a long time thereafter, Eastover did absolutely nothing to protect itself from the provisions of Section 365(d)(4). It does it no good to now argue that it was denied its constitutional rights when it did nothing to try to protect them.

In conclusion, if a debtor such as Austin wants to assume a lease, the procedure is [p. 22] rather simple. It files an appropriate motion within 60 days, notices all interested parties, and gets the matter brought on for hearing. If it does not want to accept a lease, it can do nothing and the lease is rejected as a matter of law and the estate does not continue to accrue excessive liabilities.

In this case, the proper actions were not taken to assume the lease and it was rejected.

Although it may be argued in a particular case that automatic rejection causes a harsh result, there seems to be no end to arguments and excuses that can be offered when a debtor or its attorney fails to do the simple things that are required. Based on experience, this Court agrees with Judge Wallace in the Sea Harvest case, 868 F.2d 1077, at 1079 where he endorsed the following from the opinion of the District Court: (Reading) strict compliance with these requirements avoids ad hoc inquiries into the meaning of the debtors words and actions. Anything short of this standard risks uncertainty, which is exactly what Section 365(d)(4) was designed to remedy.

Accordingly, pursuant to Rule 9021 [p. 23] separate judgments will be entered consistent with this opinion.

The two citations that I want to now add *In re U.S. FAX, INC.*, is reported at 114 B.R. Page 70. It was issued on April the 25th 1990. The other is *In re CHRIS KAY-FOODS EAST, INC.*, reported at 118 B.R., Page 70.

We now stand adjourned.

MR. SCANLON: May I ask the Court a couple of questions, please, sir? We have two arguments that your ruling does not address. One was the issue of waiver by Sowashee. They accepted rent after the period of time that they claim that the lease was rejected and they accepted it. They were actually payed [sic] the April rent twice under the stipulation. And they accepted rent after the period of time that you've held that the lease was rejected and before the Court order was entered

which said that by entering into the order that no one waived any rights. And I request that the Court make findings on that.

THE COURT: All right. I thought that I answered that in part when I went over one of the cases [p. 24] over this particular one of Judge Ayers in the *Giles* case but it's the Court's opinion that accepting of rent does not operate as an estoppel of waiver, waiver or estoppel and those type payments are mandated by 365 (d)(3). But to go further I realize that there are cases out there that hold that actions of a particular landlord, land owner, can operate as estoppel of waiver but I saw nothing in this case that I thought, I saw no action on the part of Sowashee in this case that I thought rose to the level of waiver or estoppel and I find that none of the actions constitute a waiver or estoppel.

MR. SCANLON: All right, sir. The other issue that we raised in our counterclaim, Your Honor, related to Paragraph 21 of the ground lease which is Exhibit 3 to the stipulation and we quoted at length on pages 20 to 22 of our brief which provides that if the lease is terminated, the bank's got to give, excuse me, Sowashee's got to give the bank notice and the bank has 30 days in which to enter into a lease on same terms and we had requested in our counterclaim as part of our alternative relief that the Court enforce that [p. 25] provision and enjoin and order Sowashee to fulfill its duties under the ground lease. And if the bank gives the proper notice within 30 days to require Sowashee to enter into a new lease for the premises for the remainder of the term at the rent and upon the same terms and conditions as included in the ground lease.

THE COURT: All right. Now, I also thought I had answered that question by adopting the opinion of Judge Ayers in the *Giles* case dealing with provisions of the lease – the landlord trying to argue provisions of the lease to get around the provision 365(d)(4). 365(d)(4) cuts through all of those type lease provisions. They – 365(d)(4) is a separate federal code section and hadn't got [sic] anything to do with defaults and all those things under that lease.

And, so, to the extent that you raised those arguments, I find against you.

MR. SCANLON: All right, sir. The last thing, Your Honor, we'll probably take an appeal. I would move the Court to stay the effect of the opinion pending an appeal.

[p. 26] THE COURT: Well, I anticipated it would be appealed. And, as you know, I set the thing back pretty early so I wouldn't hold you up and hope you can get it appealed on up and get a final answer, and that's the reason I held up dismissal also. But I'm not prepared, at this moment, to rule on any stays, but I will be happy to take that up with you at a later time.

MR. SCANLON: Thank you, Your Honor.

THE COURT: But first, you get the order entered, and we'll go from there.

MR. SCANLON: Thank you, Your Honor.

THE COURT: I would ask that the attorneys prepare the necessary judgments.

MR. WEBB : Yes, sir, I'll prepare the judgments and circulate them, Your Honor.

(CONCLUDED)

* * *

[p. 27] CERTIFICATE OF COURT REPORTER

I, Lacy F. Durham, Court Reporter and Notary Public in and for the Counties of Hinds/Rankin, State of Mississippi, hereby certify that the foregoing 27 pages, and including this page, contain a true and correct transcript of the testimony of the witness, as taken by me at the time and place heretofore stated, and later reduced to typewritten form by compu er-aided transcription under my supervision to the best of my skill and ability.

I further certify that I am not in the employ of or related to any counsel or party in this matter, and have no interest, monetary or otherwise, in the final outcome of the proceedings.

Witness my signature and seal this the 2nd day of October, 1991.

/s/ Lacy F. Durham
LACY F. DURHAM
Court Reporter/Notary Public
My Commission Expires
August 19, 1995

APPENDIX F

IN THE UNITED STATES BANKRUPTCY COURT
FOR THE SOUTHERN DISTRICT OF MISSISSIPPI

IN RE:

AUSTIN DEVELOPMENT CO. CASE NO. 9100018 MC

SOWASHEE VENTURE AND UNITED
ARTISTS THEATRE CIRCUIT, INC. PLAINTIFFS

V. ADVERSARY NO. 910130

AUSTIN DEVELOPMENT CO. AND
EASTOVER BANK FOR SAVINGS DEFENDANTS

ORDER REJECTING AND TERMINATING LEASE, CANCELING LIENS, AND LIFTING STAY

(Filed Oct. 21, 1991)

THIS CAUSE came on for hearing on the following matters: (1) the complaint of Sowashee Venture and United Artists Theatre Circuit, Inc. (hereafter jointly "Sowashee") to avoid and cancel liens and interest, and the answer and counterclaim of Eastover Bank for Savings ("Bank"); (2) Sowashee's Motion for Relief from Automatic Stay, Abandonment and Rejection of the Lease; (3) the application for interpleader of R&S Theatre, Inc. ("R&S") and Bank's response and claim for funds; and (4) the motion of Debtor, Austin Development Co.

("Debtor") to dismiss case. After reviewing the stipulation entered by the parties with exhibits thereto, additional oral testimony, and briefs and argument of counsel, the Court finds:

(a) The findings of fact and conclusions of law stated by the court in its bench ruling on September 24, 1991, are incorporated herein by reference.

(b) Pursuant to Bankruptcy Code § 365(d)(4), the ground lease between Sowashee (as successor to the interest of Agent's Financing, Inc.) and Debtor was rejected on March 4, 1991.

(c) The effect of the estate's rejection pursuant to § 365(d)(4) was the termination and extinguishment of the ground lease between Sowashee and Debtor.

(d) The termination of the ground lease resulted in termination and extinguishment of the lien held by the Bank on the Debtor's leasehold interest; the termination and extinguishment of Debtor's interest in the sublease to R&S; and the termination and extinguishment of the assignment to Bank of Debtor's interest in the sublease to R&S.

(e) Pursuant to the non-disturbance agreement of November 29, 1983, the sublease of R&S Theatres remains in effect and inures to the benefit of Sowashee (as successor to the interest of Agent's Financing, Inc.)

(f) Since the ground lease between Sowashee and Debtor terminated, Bank does not have the right to enforce paragraph 21 of the ground lease or to require Sowashee to enter into lease with Bank on the same terms and conditions.

(g) All funds interplead into this Court by R&S, are for rent accruing after March 4, 1991, and Sowashee is entitled to receive all interplead funds.

(h) The Court declines to rule on Bank's contention that Bankruptcy Code § 365(d)(4) is unconstitutional insofar as it affects Bank's deeds of trust, assignments and other security.

IT IS, THEREFORE, ORDERED AND ADJUDGED that:

1. The Court declares and adjudicates that the ground lease between Sowashee (as successor to Agent's Financing, Inc.) and Debtor was rejected, terminated, and extinguished on March 4, 1991.

2. The Court declares and adjudicates that the Debtor's interest in the sublease to R&S was terminated and extinguished on March 4, 1991.

3. The Court declares and adjudicates that the sublease of R&S Theatres remains in effect and inures to the benefit of Sowashee (as successor to the interest of Agent's Financing, Inc.)

4. The Court declares and adjudicates that the deed of trust from Debtor to Bank on Debtor's interest in the ground lease from Sowashee to Debtor and the lien of such deed of trust were terminated and extinguished on March 4, 1991.

5. The Court declares and adjudicates that the assignment from Debtor to Bank of Debtor's interest in the sublease R&S was terminated and extinguished on March 4, 1991.

6. The automatic stay of Bankruptcy Code § 362(a) is terminated as it relates to the ground lease and the property covered by the ground lease and to Sowashee's right to enter and take possession of the property formerly covered by the ground lease.

7. Debtor is ordered and directed immediately to surrender possession of the leased premises to Sowashee.

8. The Clerk of the Court is directed, authorized, and empowered to pay all funds interplead by R&S to Sowashee.

9. The Court reserves ruling on Debtor's Motion to Dismiss.

SO ORDERED AND ADJUDGED on October 21st, 1991.

Original signed by
EDWARD ELLINGTON
BANKRUPTCY JUDGE
U.S. BANKRUPTCY JUDGE

APPROVED AS TO FORM:

/s/ Thomas L. Webb
Thomas L. Webb, Attorney for Sowashee Venture and United Artists Theatre Circuit, Inc.

/s/ Robert H. Compton
Robert H. Compton, Attorney for R & S Theatres

/s/ Derek A. Henderson
Derek Henderson, Attorney for Austin Development Company

/s/ John S. Simpson
John S. Simpson, Attorney for
Eastover Bank for Savings

APPENDIX G

IN THE UNITED STATES BANKRUPTCY COURT
FOR THE SOUTHERN DISTRICT OF MISSISSIPPI

IN RE:

AUSTIN DEVELOPMENT CO. CASE NO. 9100018 MC

SOWASHEE VENTURE AND UNITED
ARTISTS THEATER CIRCUIT, INC. PLAINTIFFS

V. ADVERSARY NO. 910130

AUSTIN DEVELOPMENT CO. AND
EASTOVER BANK FOR SAVINGS DEFENDANTS

STIPULATION

Sowashee Venture ("Sowashee"), United Artists Theater Circuit, Inc. ("United Artists"), Austin Development Co., Inc. ("Austin"), Eastover Bank for Savings ("Bank"), and R & S Theaters ("R & S"), being all of the parties in interest, hereby stipulate for the purposes of the August 28, 1991, hearing, and any adjournment or continuation thereof that the following facts are true:

1. On January 2, 1991, Austin filed a petition for Chapter 11 proceeding with this Court.

2. On March 28, 1991, Sowashee and United Artists filed a motion for relief for automatic stay, abandonment, and rejection of the lease, Motion No. 910395, which is set for hearing on August 28, 1991.

3. On May 28, 1991, Sowashee and United Artists filed a complaint to avoid liens and interests and cancel liens, Adversary No. 910130, which is set for hearing on August 28, 1991. Bank filed its answer and counterclaim on July 3, 1991. Austin filed its answer on July 17, 1991.

4. The United States Bankruptcy Court for the Southern District of Mississippi has venue and subject matter jurisdiction of these proceedings.

5. On August 12, 1971, the Hamilton Estate, Inc., the owner of the subject real property, executed a lease to S. Norris Broadhead and Paul E. Broadhead, individually, as Executors of the Estate of Sam E. Broadhead, Deceased, and as Trustees of the Sam E. Broadhead Trust. A true copy of the lease is attached as Exhibit "1".

6. On March 20, 1974, S. Norris Broadhead and Paul E. Broadhead, individually, as Executors of the Estate of Sam E. Broadhead deceased, as Trustees of the Sam E. Broadhead Trust, executed an assignment of the lease to Agent's Financing, Inc. ("Agent's"). A true copy of such assignment of lease is attached as Exhibit "2".

7. On March 28, 1983, Agent's executed a ground lease to Austin (hereafter called "Ground Lease"). A true copy of such ground lease is attached as Exhibit "3". The Ground Lease covers non-residential real property.

8. On April 12, 1983, Austin executed a sublease to Texas Cinema Corporation (hereafter called "Sublease"). A true copy of the sublease is attached as Exhibit "4".

9. On November 30, 1983, Texas Cinema Corp. executed an assignment and assumption of Sublease and

consent to R & S. A copy of the assignment and assumption is attached as Exhibit "5".

10. On November 20, 1986, United Artists entered into an agreement with Austin. A copy of the agreement is attached as Exhibit "6".

11. On November 29, 1983, Agent's entered into a non-disturbance agreement with R & S. A copy of the agreement is attached as Exhibit "7".

12. On November 30, 1983, Hamilton Estate, Inc. entered into a non-disturbance agreement with R & S. A copy of the agreement is attached as Exhibit "8".

13. On February 14, 1985, Agent's filed an assignment of lease dated April 29, 1974, to S. Norris Broadhead and Paul E. Broadhead, as Trustees of the Sam Broadhead Trust. A copy of the assignment is attached as Exhibit "9".

14. Pursuant to orders and decrees of the Chancery Court of Lauderdale County, Mississippi, in the Matter of the Estate of Sam E. Broadhead, Deceased, the Sam Broadhead Trust properties were distributed to S. Norris Broadhead and Paul E. Broadhead.

15. On February 1, 1985, S. Norris Broadhead executed a warranty deed to Sowashee, a general partnership. A copy of the warranty deed is attached as Exhibit "10".

16. On February 1, 1985, Paul Broadhead executed a warranty deed to Sowashee, a general partnership. A copy of the deed is attached as Exhibit "11".

17. Sowashee is the current holder of and successor in title to the Ground Lease on non-residential real properly with Austin (Exhibit "3" hereto).

18. On December 30, 1986, Austin borrowed $850,000.00 from Bank and as security therefor executed the following documents:

(a) A deed of trust to E. Frank Goodman, as Trustee for Bank, covering Austin's interest in the Ground Lease, a copy of which is attached as Exhibit "12"; and

(b) An assignment to Bank of Austin's sublessor's interest in the Sublease to R & S, a copy of the assignment attached as Exhibit "13".

19. Mr. Charles Young, Vice-President of the Meridian branch of Bank would testify that:

(a) He is the officer in charge of Austin's accounts and loans and is familiar with the Bank's transactions with Austin.

(b) The original $850,000.00 promissory note has been renewed and has been combined with other indebtedness. In addition, Bank has advanced additional principal sums to Austin covered by the promissory note and securing deed of trust and assignment. Austin has continuously been indebted to Bank on the December 30, 1986, promissory note.

(c) As of August 28, 1991, the principal outstanding balance is $918,308.32, and the accrued interest is $43,033.44. Interest accrues after August 28, 1991, at $264.17 per day.

20. On December 31, 1986, Bank's attorney wrote Sowashee and gave notice that Bank's deed of trust and assignment and stated:

> "Please send all notices required by paragraph 21 of the ground lease to Eastover Bank for Savings."

21. On January 6, 1987, Bank's attorney wrote R & S and notifying them of the assignment of the Sublease to the Bank and requesting that all future payments be made to Bank.

22. From January, 1987, through March, 1991, R & S paid Bank all of the monthly payments (approximately $11,085 per month) under the Sublease to Bank; and during such time Bank paid Sowashee all monthly payments ($1,500 per month), plus common area costs, due under the Ground Lease.

23. On or about April 1, 1991, when Bank received R & S' check for $11,085.79 for the April, 1991 rent, Bank issued its check to Sowashee for $1,574.00 for the April 1991 payments under the Ground Lease. On March 28, 1991, Sowashee notified R & S not to pay Bank, and as a result R & S stopped payment on its check to Bank. Bank was unable to collect the R & S check.

24. On March 29, 1991, R & S filed an application for interpleader, a copy of which is attached as Exhibit "14". After pleadings by various parties, on April 5, 1991, the Court entered an order directing investment of interpled funds, copy attached as Exhibit "15". The Clerk's registry control account for the interpled funds, showing payments received and the disbursement made from the

interpled funds, is attached as Exhibit "16". As of August 28, 1991, the balance in the fund is $48,027.30.

25. On July 23, 1991, this Court entered an interim agreed order concerning interpleader funds, a copy of which is attached as Exhibit "17". The parties have and are complying with this order. Pursuant to the order, R & S is paying Sowashee directly the $1,500.00 of monthly rent due, plus common area maintenance of about $75.00 per month, under the Ground Lease (Exhibit "3" hereto) and is paying the balance of its rent under the Sublease to the Clerk of this Court under the April 5, 1991, order (Exhibit "15" hereto).

26. On August 19, 1991, this Court entered an order directing Clerk to disburse a portion of interpled funds to Sowashee. A copy of such order is attached as Exhibit "18". Sowashee has been paid the $7,862.20 covered by this order.

27. On February 19, 1991, Austin filed a motion to modify stay, a copy of which is attached as Exhibit "19". On March 19, 1991, the Court entered an Agreed Order Modifying Automatic Stay, a copy of which is attached as Exhibit "20". Austin has not filed any other motions relating to the Ground Lease or to the Sublease.

28. Sowashee has not given Bank any notice of any alleged breach by Austin of the Ground Lease or of any cancellation or termination of the Ground Lease (Exhibit "3" hereto).

29. The chain of title for the Ground Lease in Miss Alva, Inc., Case No. 90-004114MC, is the same as set out

hereinabove, and the current title holder and successor of the lease interest is Sowashee.

Dated: August 28, 1991.

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Attorneys for Debtor Austin
Development Co., Inc.

CONTENTS

EXHIBIT NUMBER — DESCRIPTION

1 Lease from the Hamilton Estate, Inc. to S. Norris Broadhead and Paul E. Broadhead, individually, as Executors of the Estate of Sam E. Broadhead, individually, as Executors of the Estate of Sam E. Broadhead, Deceased, and as Trustees of the Sam E. Broadhead Trust, dated August 12, 1971

2 Assignment from S. Norris Broadhead and Paul E. Broadhead, individually, as Executors of the Estate of Sam E. Broadhead, deceased, as Trustees of the Sam E. Broadhead Trust to Agent's Financing, Inc. dated March 20, 1974

3 Agent's Financing ground lease to Austin Development, Inc., dated March 28, 1983

4 Austin sublease to Texas Cinema Corporation, dated April 12, 1983

5 Assignment and assumption of Sublease and Consent from Texas Cinema Corp. to R & S Theaters, dated November 30, 1983

6 United Artists agreement with Austin, dated November 20, 1986

7 Agent's Non-disturbance Agreement with R & S, dated November 29, 1983

8 Non-disturbance Agreement between the Hamilton Estate, Inc. and R & S, dated November 30, 1983

9 Agent's Assignment of the April 29, 1974 lease to S. Norris Broadhead and Paul E. Broadhead, as Trustees of the Sam Broadhead Trust, dated February 14, 1985

10 S. Norris Broadhead warranty deed to Sowashee, on February 1, 1985

11 Paul Broadhead warranty deed to Sowashee, dated February 1, 1985

12 Deed of Trust to E. Frank Goodman, Trustee for Eastover Bank for Savings, covering Austin's interest in the Ground Lease, dated December 30, 1986

13 Assignment to Eastover Bank of Austin's sublessor's interest in the Sublease to R & S, dated December 30, 1986

14 R & S Application for Interpleader, dated April 4, 1991

15 Order directing investment of interpled funds, entered on April 5, 1991

16 The Court's registry control account for the interpled funds, showing payments received and disbursements made from interpled funds

17 Interim agreed Order concerning interpled funds, entered July 23, 1991

18 Order directing the Clerk to disburse a portion of interpled funds to Sowashee, entered August 19, 1991

19 Motion to Modify Stay, filed by Austin on February 19, 1991

20 Agree Order Modifying Automatic Stay, entered March 19, 1991

SIMPLIFIED CHART

